

08043004

# United Security Bancshares, Inc.

PARENT COMPANY OF FIRST UNITED SECURITY BANK

Received SEC

APR 02 2008

Washington, DC 20549

PROCESSED

APR 08 2008

THOMSON  
FINANCIAL

Annual Report  
**2007**

## **UNITED SECURITY BANCSHARES, INC.**

<i>Directors</i>	Dan R. Barlow	Jack W. Meigs
	Linda H. Breedlove	R. Terry Phillips
	Gerald P. Corgill	Ray Sheffield
	Wayne C. Curtis	James C. Stanley
	John C. Gordon	Howard M. Whitted
	William G. Harrison	Bruce N. Wilson
	Hardie B. Kimbrough	

## **FIRST UNITED SECURITY BANK**

<i>Directors</i>	Dan R. Barlow	Jack W. Meigs
	Linda H. Breedlove	R. Terry Phillips
	Gerald P. Corgill	Ray Sheffield
	Wayne C. Curtis	James C. Stanley
	John C. Gordon	Howard M. Whitted
	William G. Harrison	Bruce N. Wilson
	Hardie B. Kimbrough	

## **ACCEPTANCE LOAN COMPANY, INC.**

<i>Directors</i>	Dan R. Barlow	Ray Sheffield
	Chris Mitchell	James C. Stanley
	William D. Morgan	Robert Steen
	R. Terry Phillips	Bruce N. Wilson

## **FIRST SECURITY COURIER CORPORATION**

<i>Directors</i>	William D. Morgan	Larry M. Sellers
------------------	-------------------	------------------

## **FUSB REINSURANCE, INC.**

<i>Directors</i>	J. Daniel Matheson, III	Ray Sheffield
	Jack W. Meigs	Bruce N. Wilson
	R. Terry Phillips	

## **R2METRICS, INC.**

<i>Directors</i>	Wayne C. Curtis	J. Daniel Matheson, III
	John C. Gordon	R. Terry Phillips
	Hardie B. Kimbrough	

Dear Shareholder:

The year 2007 was very challenging for our company. As compared with the outstanding financial performances of our company in previous years, the performance of our company in 2007 was disappointing, and well below the expectations of our shareholders, management and Board of Directors. Nevertheless, your Board of Directors and management are committed to the goal of this company once again attaining the status of a high performing financial institution during 2008.

As you are probably aware, our finance company subsidiary, Acceptance Loan Company, was victimized by an extensive internal fraud that resulted in a loss for ALC during 2007 of approximately \$8.3 million, net of taxes. Beginning in May 2007 and continuing through year-end, we carried out comprehensive and in-depth investigations of ALC so as to determine the full extent of this fraudulent activity and to identify all individuals who were involved. All employees identified as participants in this fraudulent activity are no longer employees of the company.

Many changes have been subsequently implemented within ALC. The process of restructuring senior management was begun in mid-year 2007 and has continued as additional senior level officers have been added, including a full-time in-house internal auditor. A new outside audit firm has also been retained for ongoing internal audit review of the company. Several other changes have been made so as to strengthen the overall operation of ALC and to return it to a profitable condition.

First United Security Bank posted a strong net income of \$8.8 million for the year, providing a solid foundation for overall improvement going forward. Net income company-wide for the

year was \$349,000, after the effect of Acceptance Loan Company losses.

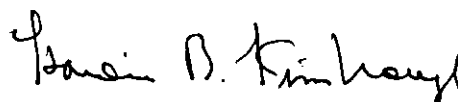
The company experienced moderate growth over the past year. Average assets increased 4.0% to \$660.9 million. Deposits, on average, grew \$36.7 million to \$479.9 million, while loans also increased slightly to \$449.6 million.

Annual dividends for USBI shareholders increased for the 19th consecutive year to \$1.19 per share. We are very pleased to have continued this record of providing a strong level of return to our shareholders through payment of dividends.

Our business will always depend and succeed on the many relationships we develop with our customers and the communities we serve. As fellow shareholders, as well as members of the Board of Directors, we encourage you to actively support our company by allowing us to provide your personal financial needs and by referring others, so as to allow us to also provide them with quality financial services.

As previously stated, we are committed to returning this company to the level of performance that we have historically provided. Thank you again for your investment and your support.

Sincerely,



Hardie B. Kimbrough  
*Chairman, Board of Directors*



R. Terry Phillips  
*President and CEO*

**SEC Mail Processing  
Section**

**APR 02 2008**

**Washington, D.C.  
110**

**UNITED SECURITY BANCSHARES, INC. AND SUBSIDIARIES**  
**SELECTED FINANCIAL DATA**

	Year Ended December 31,				
	2007	2006	2005	2004	2003
	(In Thousands of Dollars, Except Per Share Amounts)				
RESULTS OF OPERATIONS					
Interest Income .....	\$ 59,983	\$ 59,219	\$ 52,679	\$ 49,434	\$ 46,722
Interest Expense .....	19,464	15,992	11,810	10,369	11,197
Net Interest Income .....	40,519	43,227	40,869	39,065	35,525
Provision for Loan Losses .....	21,152	3,726	3,853	3,724	3,505
Non-Interest Income .....	5,566	5,621	5,278	5,755	5,724
Non-Interest Expense .....	25,804	23,782	23,059	22,045	21,306
Income (Loss) Before Income Taxes .....	(871)	21,340	19,235	19,051	16,438
Income Tax Expense (Benefit From) .....	(1,220)	7,095	5,579	5,920	5,023
Net Income .....	\$ 349	\$ 14,245	\$ 13,656	\$ 13,131	\$ 11,415
Net Income Per Share					
Basic and Diluted Net Income Per Share .....	\$ 0.06	\$ 2.24	\$ 2.12	\$ 2.04	\$ 1.77
Average Number of Shares Outstanding .....	6,174	6,367	6,428	6,431	6,432
PERIOD END STATEMENT OF CONDITION					
Total Assets .....	\$ 659,896	\$ 646,296	\$ 621,483	\$ 586,153	\$ 567,188
Loans, Net .....	427,588	441,574	431,527	396,922	379,736
Deposits .....	478,554	450,062	426,231	400,451	387,680
Long-Term Debt .....	77,518	87,553	89,588	89,637	95,755
Shareholders' Equity .....	79,569	91,596	87,709	81,913	73,329
AVERAGE BALANCES					
Total Assets .....	\$ 660,872	\$ 635,588	\$ 607,837	\$ 582,048	\$ 549,705
Earning Assets .....	601,131	578,949	552,846	533,008	511,220
Loans, Net of Unearned Discount .....	449,577	444,094	418,548	391,435	365,532
Deposits .....	479,939	443,273	417,666	391,852	372,142
Long-Term Debt .....	77,148	84,010	90,715	99,028	100,547
Shareholders' Equity .....	85,648	88,768	85,154	77,623	69,421
PERFORMANCE RATIOS					
Net Income to:					
Average Total Assets .....	0.05%	2.24%	2.25%	2.26%	2.08%
Average Shareholders' Equity .....	0.41%	16.05%	16.04%	16.92%	16.44%
Average Shareholders' Equity to:					
Average Total Assets .....	12.96%	13.97%	14.01%	13.34%	12.63%
Dividend Payout Ratio .....	2,104.78%	47.89%	44.75%	35.27%	37.75%

# MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

## Introduction

United Security Bancshares, Inc., a Delaware corporation ("United Security" or the "Company"), is a bank holding company with its principal offices in Thomasville, Alabama. United Security operates one commercial banking subsidiary, First United Security Bank (the "Bank"). At December 31, 2007, the Bank operated nineteen banking offices located in Brent, Bucksville, Butler, Calera, Centreville, Coffeetown, Columbiana, Fulton, Gilbertown, Grove Hill, Harpersville, Jackson, Thomasville, Tuscaloosa, and Woodstock, Alabama. Its market area includes Clarke, Choctaw, Bibb, Shelby, Tuscaloosa and portions of Marengo, Sumter, Washington, Wilcox, Chilton, Hale, Monroe, Perry and Jefferson Counties in Alabama, as well as Clarke, Lauderdale, and Wayne Counties in Mississippi.

United Security is also the parent company of First Security Courier Corporation ("FSCC"), an Alabama corporation. FSCC is a courier service organized to transport items for processing to the Federal Reserve for companies located in Southwest Alabama.

The Bank owns all of the stock of Acceptance Loan Company, Inc. ("ALC"), an Alabama corporation. ALC is a finance company organized for the purpose of making and purchasing consumer loans. ALC has twenty-five offices located in Alabama and Southeast Mississippi. The headquarters of ALC is located in Jackson, Alabama. The Bank is the funding source for ALC.

The Company's sole business is banking; therefore, loans and investments are its principal sources of income. The Bank contributed approximately \$8.9 million to consolidated net income in 2007, while ALC generated a loss of approximately \$8.3 million, net of tax. The loss experienced at ALC was due to loan irregularities discovered in 2007. For more information related to these loan irregularities, see the section titled, "Irregularities at Acceptance Loan Company, Inc." The Bank provides a wide range of commercial banking services to small and medium-sized businesses, real estate developers, property managers, business executives, professionals and other individuals.

FUSB Reinsurance, Inc. ("FUSB Reinsurance"), an Arizona corporation and wholly-owned subsidiary of the Bank, reinsures or "underwrites" credit life and credit accident and health insurance policies sold to the Bank's and ALC's consumer loan customers. FUSB Reinsurance is responsible for the first level of risk on these policies up to a specified maximum amount, and a primary third-party insurer retains the remaining risk. The third-party insurer is also responsible for performing most of the administrative functions of FUSB Reinsurance on a contract basis.

R2Metrics, Inc. ("R2Metrics"), an Alabama corporation and wholly-owned subsidiary of the Bank, was incorporated in April 2007. R2Metrics provides investment and asset and liability management software, analytics, and consulting services for the Bank as well as other clients. The company is headquartered in Birmingham, Alabama.

At December 31, 2007, United Security had consolidated assets of \$660.0 million, deposits of \$478.6 million, and shareholders' equity of \$79.6 million. Total assets increased by \$13.6 million, or 2.1%, in 2007. Net income decreased from \$14.2 million in 2006 to \$349,000 in 2007, primarily due to losses suffered at ALC. Net income per share decreased from \$2.24 in 2006 to \$0.06 in 2007.

Delivery of the best possible services to customers remains an overall operational focus of the Bank. We recognize that attention to details and responsiveness to customers' desires are critical to customer satisfaction. The Company continues to employ the most current technology, both in its financial services and in the training of its 283 full-time employees, to ensure customer satisfaction and convenience.

The following discussion and financial information are presented to aid in an understanding of the current financial position and results of operations of United Security, and should be read in conjunction with the Audited Consolidated Financial Statements and Notes thereto included herein. The emphasis of this discussion will be on the years 2007, 2006, and 2005. All yields presented and discussed herein are based on the accrual basis and not on the tax-equivalent basis, unless otherwise indicated.

## Forward-Looking Statements

This Annual Report, annual and periodic reports filed by United Security and its subsidiaries under the Securities and Exchange Act of 1934, as amended, and any other written or oral statements made by or on behalf of United Security may

include "forward-looking statements," within the meaning of the Private Securities Litigation Reform Act of 1995, that reflect United Security's current views with respect to future events and financial performance. Such forward-looking statements are based on general assumptions and are subject to various risks, uncertainties and other factors that may cause actual results to differ materially from the views, beliefs and projections expressed in such statements. These risks, uncertainties and other factors include, but are not limited to:

1. Possible changes in economic and business conditions that may affect the prevailing interest rates, the prevailing rates of inflation, or the amount of growth, stagnation, or recession in the global, U.S., Alabama and Mississippi economies, the value of investments, the collectibility of loans and the ability to retain and grow deposits;
2. Possible changes in monetary and fiscal policies, laws and regulations, and other activities of governments, agencies and similar organizations;
3. The effects of easing of restrictions on participants in the financial services industry, such as banks, securities brokers and dealers, investment companies and finance companies, other potential regulatory changes, and attendant changes in patterns and effects of competition in the financial services industry;
4. The ability of United Security to achieve its expected operating results including the continued growth of the markets in which United Security operates consistent with recent historical experience and United Security's ability to expand into new markets and to maintain profit margins; and
5. Recently, the residential mortgage market in the United States has experienced a variety of worsening economic conditions that may adversely affect the performance and market value of United Security residential construction and mortgage loans. Across the United States, delinquencies, foreclosures and losses with respect to residential construction and mortgage loans generally have increased in recent months and may continue to increase. In addition, in recent months, housing prices and appraisal values in many states have declined or stopped appreciating; after extended periods of significant appreciation, housing values may remain stagnant or decline in the near term. An extended period of flat or declining housing values may result in increased delinquencies and losses on residential construction and mortgage loans.

In addition, United Security's business is subject to a number of general and market risks that would affect any forward-looking statements.

The words "believe," "expect," "anticipate," "project," and similar expressions, signify forward-looking statements. Readers are cautioned not to place undue reliance on any forward-looking statements made by or on behalf of United Security. Any such statements speak only as of the date such statements were made, and United Security undertakes no obligation to update or revise any forward-looking statements.

### **Irregularities at Acceptance Loan Company, Inc.**

As a result of internal procedures of the Company, evidence was discovered during the second quarter of 2007 suggesting irregularities in certain loan transactions within ALC, a subsidiary of the Company. The irregularities have been identified to be primarily related to four out of the twenty-five ALC branches and were largely related to (a) the making of improper or fraudulent loans, (b) techniques used to conceal delinquent loans, (c) the improper or fraudulent handling of repossessed automobiles and (d) the inflation of appraisals on certain real estate collateral. The Company, under the direction of the Audit Committee, has conducted an internal investigation relating to these irregularities with the assistance of outside legal counsel, as well as an outside forensic accounting firm. The internal investigation is substantially complete.

As a result of the investigation, the results of operations for the year ended December 31, 2007, include a charge-off of loans and a write down of real estate collateral values relating to the irregularities of \$12.5 million in ALC's loan and other real estate portfolio. These losses reduced the net income of the Company by \$8.3 million, net of tax benefit, or \$1.34 per basic and diluted share for the year ended December 31, 2007. The Company believes that it will not need to make any additional loan loss provision related to these irregularities; however, no assurance can be given that any additional loss provision will not be required in the future relating to the irregularities. In addition to these losses, the Company has incurred a substantial amount of legal, accounting and associated expenses relating to the investigation of these irregularities, which expenses are reflected in the Company's non-interest expense balance for the year ended December 31, 2007. The Company expects to incur additional legal and accounting expenses relating to the irregularities during 2008, although on a smaller scale.

It has been determined that the irregularities were limited to one district of the ALC branch system and were primarily related to four of the branches within that district. The branch managers previously employed at these four branches, the district manager who had been supervising the district in question, and the former CEO of ALC are no longer employed at ALC. Although there is the potential for insurance recovery and recoveries from civil actions, the amounts and timing of such recoveries cannot be estimated at this time. The Company plans to vigorously pursue available avenues of recovery for these losses, including insurance and civil claims.

Since the discovery of the loan irregularities at ALC, internal controls have been revised and additional policies and procedures have been implemented. An in-house internal auditor has been hired by ALC, who reports to the newly formed audit committee. A loan committee was established to help oversee the lending function. With the assistance of the loan committee, the loan policy has been revised and implemented, with continued training a priority.

## **Critical Accounting Policies and Estimates**

The preparation of the Company's financial statements requires management to make subjective judgments associated with estimates. These estimates are necessary to comply with accounting principles generally accepted in the United States and general banking practices. These areas include accounting for the allowance for loan losses, derivatives, deferred income taxes, and supplemental compensation benefits agreements.

The Company maintains the allowance for loan losses at a level deemed adequate by management to absorb possible losses from loans in the portfolio. In determining the adequacy of the allowance for loan losses, management considers numerous factors, including but not limited to management's estimate of future economic conditions, the financial condition and liquidity of certain loan customers, and collateral values of property securing certain loans. Because these factors and others involve the use of management's estimation and judgment, the allowance for loan losses is inherently subject to adjustment at future dates. Unfavorable changes in the factors used by management to determine the adequacy of the allowance, including increased loan delinquencies and subsequent charge-offs, or the availability of new information, could require additional provisions, in excess of normal provisions, to the allowance for loan losses in future periods.

Both fair-value and cash-flow hedges require assumptions related to the impact of changes in interest rates on the fair value of the derivative and the item being hedged. These assumptions are documented at inception to demonstrate effective hedging of the designated risk. If these assumptions do not accurately reflect future changes in the fair value, the Company may be required to discontinue the use of hedge accounting for a derivative. This change in accounting treatment could affect current period earnings.

Management's determination of the realization of a deferred tax asset is based upon management's judgment of various future events and uncertainties, including the timing and amount of future income earned by subsidiaries and the implementation of various tax planning strategies to maximize realization of the deferred tax asset. Management believes that the subsidiaries will be able to generate sufficient operating earnings to realize the deferred tax benefits. As management periodically evaluates the ability of the Bank to realize the deferred tax asset, subjective judgments are made that may impact the resulting provision for income tax.

The Company and the Bank have entered into supplemental compensation benefits agreements with the directors and certain executive officers. The measurement of the liability under the agreements includes estimates involving life expectancy, length of time before retirement and the expected returns on the Bank-owned life insurance policies used to fund the agreements. Should these estimates prove materially wrong, the cost of the agreements could change accordingly.

## Summary of Operating Results

	Year Ended December 31,		
	2007	2006	2005
	(In Thousands of Dollars)		
Total Interest Income .....	\$59,983	\$59,219	\$52,679
Total Interest Expense .....	19,464	15,992	11,810
Net Interest Income .....	40,519	43,227	40,869
Provision for Loan Losses .....	21,152	3,726	3,853
Net Interest Income After Provision for Loan Losses .....	19,367	39,501	37,016
Non-Interest Income .....	5,566	5,621	5,278
Non-Interest Expense .....	25,804	23,782	23,059
(Loss) Income Before Income Taxes .....	(871)	21,340	19,235
Applicable Income Tax Expense, (Benefit) .....	(1,220)	7,095	5,579
Net Income .....	<u>\$ 349</u>	<u>\$14,245</u>	<u>\$13,656</u>

### Net Interest Income

Net interest income is an effective measurement of how well management has matched interest-earning assets and interest-bearing liabilities and is the Company's principal source of income. Fluctuations in interest rates materially affect net interest income.

Net interest income declined 6.3% to \$40.5 million in 2007, compared to an increase of 5.8% and 4.6% in 2006 and 2005, respectively. The decline in net interest income in 2007 is due to a decline in non-interest and lower interest-bearing deposits as compared to higher interest-bearing deposits. Demand deposits, savings, and money market volume decreased by 4.6%, while certificates of deposit increased 18.6%.

The Company's loan portfolio declined by \$14.0 million, or 3.2%, during 2007. However, taxable investments increased by \$24.8 million, or 20.7%.

Overall, volume, rate and yield changes in interest-earning assets and interest-bearing liabilities contributed to the decline in net interest income. The Company's average earning assets increased \$22.2 million, or 3.8%, while average interest-bearing liabilities increased \$32.7 million, or 7.1%. Thus, growth of average interest-bearing liabilities outpaced growth in average earning assets by \$10.6 million during 2007.

The Bank's ability to produce net interest income is measured by a ratio called the interest margin. The interest margin is net interest income as a percent of average earning assets. The interest margin was 6.7% in 2007, 7.5% in 2006, and 7.4% in 2005.

Interest margins are affected by several factors, one of which is the relationship of rate-sensitive earning assets to rate-sensitive interest-bearing liabilities. This factor determines the effect that fluctuating interest rates will have on net interest income. Rate-sensitive earning assets and interest-bearing liabilities are those which can be repriced to current market rates within a relatively short time. The Bank's objective in managing interest rate sensitivity is to achieve reasonable stability in the interest margin throughout interest rate cycles by maintaining the proper balance of rate-sensitive assets and interest-bearing liabilities. For further analysis and discussion of interest rate sensitivity, refer to the section entitled, "Liquidity and Interest Rate Sensitivity Management."

An additional factor that affects the interest margin is the interest rate spread. The interest rate spread measures the difference between the average yield on interest-earning assets and the average rate paid on interest-bearing liabilities. This measurement is a more accurate reflection of the effect market interest rate movements have on interest rate-sensitive assets and liabilities. The interest rate spread was 6.1% in 2007, 6.8% in 2006, and 6.9% in 2005. The average amount of interest-bearing liabilities as noted in the table, "Yields Earned on Average Interest-Earning Assets and Rates Paid on Average Interest-Bearing Liabilities," increased 7.1% in 2007, while the average rate of interest paid increased from 3.6% in 2006 to 3.9% in 2007. Average interest-earning assets increased 3.8% in 2007, while the average yield on earning assets decreased from 10.2% in 2006 to 10.0% in 2007.



The percentage of earning assets funded by interest-bearing liabilities also affects the Bank's interest margin. The Bank's earning assets are funded by interest-bearing liabilities, non-interest-bearing demand deposits, and shareholders' equity. The net return on earning assets funded by non-interest-bearing demand deposits and shareholders' equity exceeds the net return on earning assets funded by interest-bearing liabilities. The Bank maintains a relatively consistent percentage of earning assets funded by interest-bearing liabilities. In 2007, 82.6% of the Bank's average earning assets were funded by interest-bearing liabilities as opposed to 80.1% in 2006 and 80.9% in 2005.

## Yields Earned on Average Interest-Earning Assets and Rates Paid on Average Interest-Bearing Liabilities

	December 31,								
	2007			2006			2005		
	Average Balance	Interest	Yield/Rate %	Average Balance	Interest	Yield/Rate %	Average Balance	Interest	Yield/Rate %
(In Thousands of Dollars, Except Percentages)									
<b>ASSETS</b>									
Interest-Earning Assets:									
Loans (Note A) .....	\$449,577	\$52,317	11.64%	\$444,094	\$52,630	11.85%	\$418,548	\$46,914	11.21%
Taxable Investments .....	135,400	6,934	5.12%	118,136	5,829	4.93%	114,905	4,894	4.26%
Non-Taxable Investments .....	16,152	732	4.53%	16,719	760	4.55%	19,393	871	4.49%
Federal Funds Sold .....	2	0	0.00%	0	0	0.00%	0	0	0.00%
Total Interest-Earning Assets .....	<u>601,131</u>	<u>59,983</u>	<u>9.98%</u>	<u>578,949</u>	<u>59,219</u>	<u>10.23%</u>	<u>552,846</u>	<u>52,679</u>	<u>9.53%</u>
Non-Interest-Earning Assets:									
Other Assets .....	<u>59,741</u>			<u>56,639</u>			<u>54,991</u>		
Total .....	<u>\$660,872</u>			<u>\$635,588</u>			<u>\$607,837</u>		
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>									
Interest-Bearing Liabilities:									
Demand Deposits .....	\$ 75,873	\$ 631	0.83%	\$ 78,396	\$ 642	0.82%	\$ 80,295	\$ 638	0.79%
Savings Deposits .....	47,721	505	1.06%	52,487	497	0.95%	57,246	539	0.94%
Time Deposits .....	291,873	14,361	4.92%	246,199	10,553	4.29%	217,888	6,985	3.21%
Borrowings .....	<u>81,188</u>	<u>3,967</u>	<u>4.89%</u>	<u>86,825</u>	<u>4,300</u>	<u>4.95%</u>	<u>91,959</u>	<u>3,648</u>	<u>3.97%</u>
Total Interest-Bearing Liabilities ....	<u>496,655</u>	<u>19,464</u>	<u>3.92%</u>	<u>463,907</u>	<u>15,992</u>	<u>3.45%</u>	<u>447,388</u>	<u>11,810</u>	<u>2.64%</u>
Non-Interest-Bearing Liabilities:									
Demand Deposits .....	64,472			66,191			62,237		
Other Liabilities .....	14,097			16,722			13,058		
Shareholders' Equity .....	<u>85,648</u>			<u>88,768</u>			<u>85,154</u>		
Total .....	<u>\$660,872</u>			<u>\$635,588</u>			<u>\$607,837</u>		
Net Interest Income (Note B) .....		<u>\$40,519</u>			<u>\$43,227</u>			<u>\$40,869</u>	
Net Yield on Interest-Earning Assets .....			<u>6.74%</u>			<u>7.47%</u>			<u>7.39%</u>

Note A — For the purpose of these computations, non-accruing loans are included in the average loan amounts outstanding. These loans amounted to \$5,555,400, \$6,858,270, and \$5,662,303 for 2007, 2006, and 2005, respectively.

Note B — Loan fees of \$3,837,409, \$3,496,765, and \$3,205,322 for 2007, 2006, and 2005, respectively, are included in interest income amounts above.

## Changes in Interest Earned and Interest Expense Resulting from Changes in Volume and Changes in Rates

The following table sets forth the effect which varying levels of interest-earning assets and interest-bearing liabilities and the applicable rates had on changes in net interest income for 2007 versus 2006, 2006 versus 2005 and 2005 versus 2004.

	2007 Compared to 2006 Increase (Decrease) Due to Change In:			2006 Compared to 2005 Increase (Decrease) Due to Change In:			2005 Compared to 2004 Increase (Decrease) Due to Change In:		
	Volume	Average Rate	Net	Volume	Average Rate	Net	Volume	Average Rate	Net
	(In Thousands of Dollars)								
Interest Earned On:									
Loans .....	\$ 650	\$ (963)	\$ (313)	\$2,863	\$2,853	\$5,716	\$3,009	\$ 467	\$3,476
Taxable Investments .....	852	252	1,104	138	797	935	(275)	104	(171)
Non-Taxable Investments .....	(26)	(2)	(28)	(120)	9	(111)	(31)	(28)	(59)
Total Interest-Earning Assets .....	<u>1,476</u>	<u>(713)</u>	<u>763</u>	<u>2,881</u>	<u>3,659</u>	<u>6,540</u>	<u>2,703</u>	<u>543</u>	<u>3,246</u>
Interest Expense On:									
Demand Deposits .....	(21)	10	(11)	(15)	19	4	28	101	129
Savings Deposits .....	(45)	53	8	(45)	3	(42)	39	58	97
Time Deposits .....	1,958	1,850	3,808	909	2,659	3,568	145	1,239	1,384
Other Borrowings .....	(279)	(54)	(333)	(204)	856	652	(340)	171	(169)
Total Interest-Bearing Liabilities .....	<u>1,613</u>	<u>1,859</u>	<u>3,472</u>	<u>645</u>	<u>3,537</u>	<u>4,182</u>	<u>(128)</u>	<u>1,569</u>	<u>1,441</u>
(Decrease) Increase in Net Interest Income .....	\$ (137)	\$(2,572)	\$(2,709)	\$2,236	\$ 122	\$2,358	\$2,831	\$(1,026)	\$1,805

## Provision for Loan Losses

The provision for loan losses is an expense used to establish the allowance for loan losses. Actual loan losses, net of recoveries, are charged directly to the allowance. The expense recorded each year is a reflection of actual net losses experienced during the year and management's judgment as to the adequacy of the allowance to absorb losses inherent to the portfolio. Charge-offs exceeded recoveries by \$20.3 million during the year, and a provision of \$21.2 million was expensed for loan losses in 2007, compared to \$3.7 million in 2006 and \$3.9 million in 2005. Net charge-offs at the Bank were \$1.6 million as of December 31, 2007, and \$0.7 million at December 31, 2006. ALC had net charge-offs of \$18.7 million at December 31, 2007, compared to \$3.1 million at December 31, 2006. The large increase in net charge-offs and the provision for loan losses are both attributable to losses sustained as a result of the loan irregularities at ALC. See the section titled, "Irregularities at Acceptance Loan Company, Inc." Net charge-offs as a percentage of average loans were 4.53%, 0.85%, 0.77%, and 0.90% for the years ended December 31, 2007, 2006, 2005, and 2004, respectively.

The ratio of the allowance to loans net of unearned income at December 31, 2007, was 1.96%. For additional information regarding the Company's allowance for loan losses, see "Loans and Allowance for Loan Loss."

## Non-Interest Income

The following table presents the major components of non-interest income for the years indicated.

	Year Ended December 31,		
	2007	2006	2005
	(In Thousands of Dollars)		
Service Charges and Other Fees on Deposit Accounts .....	\$3,280	\$3,147	\$2,941
Credit Insurance Commissions and Fees .....	700	826	770
Bank-Owned Life Insurance .....	476	443	419
Investment Security (Losses) Gains, Net .....	(107)	0	(37)
Other Income .....	1,217	1,205	1,185
Total Non-Interest Income .....	<u>\$5,566</u>	<u>\$5,621</u>	<u>\$5,278</u>

Total non-interest income decreased \$55,000, or 1.0% in 2007. This compares to an increase of 6.5% in 2006 and a decrease of 8.3% in 2005. One factor contributing to the decrease in 2007 was a \$126,000, or 15.3%, decline in credit insurance commissions and fees, which are generated through the Bank's subsidiary, FUSB Reinsurance. The reason for the decline is due to a decrease in demand and the retirement of the Bank's top producers of this product. Efforts are being made to stimulate sales of credit insurance at the Bank.

Non-recurring items of non-interest income include securities gains and losses. Net losses resulting from securities sold amounted to \$2,000 in 2007, and \$37,000 in 2005. No gains or losses were recognized in 2006. In 2007 the Bank recognized an impairment write-down of \$105,000 related to the investment in a preferred stock. Income generated in the area of securities gains and losses is dependent on factors that include investment portfolio strategies, interest rate changes and the short, intermediate, and long-term outlook for the economy.

Service charges and other fees on deposit accounts increased \$133,000, or 4.2%, during 2007, compared to a 7.0% increase in 2006 and a decrease of 9.7% in 2005. The 2007 increase is due to increases in customer overdrafts and accounts with non-sufficient funds.

Earnings from the Company's bank-owned life insurance policies increased \$33,000, or 7.4%, during 2007, compared to an increase of 5.7% in 2006 and 13.2% in 2005. These policies were established in 2002 to assist in funding the Bank's supplemental compensation benefit agreements with directors and certain executive officers.

Other income includes fee income generated from other banking services such as letters of credit, ATM's, debit and credit cards, check cashing, and wire transfers. Other income increased \$12,000, or 1.0%, in 2007, compared to an increase of 1.7% in 2006 and a decrease of 3.4% in 2005.

## Non-Interest Expense

The following table presents the major components of non-interest expense for the years indicated.

	Year Ended December 31,		
	2007	2006	2005
	(In Thousands of Dollars)		
Compensation and Benefits .....	\$13,508	\$14,426	\$14,146
Occupancy .....	1,943	1,696	1,552
Furniture and Equipment .....	1,397	1,364	1,338
Impairment on Limited Partnerships .....	109	240	357
Legal, Accounting and Other Professional Fees .....	2,304	861	802
Stationary and Supplies .....	593	542	531
Telephone/Communication .....	648	629	429
Advertising .....	373	284	330
Collection and Recovery .....	387	294	289
Write-Down Other Real Estate .....	799	60	68
Other .....	3,743	3,386	3,217
Total Non-Interest Expense .....	<u>\$25,804</u>	<u>\$23,782</u>	<u>\$23,059</u>
Efficiency Ratio .....	56.0%	48.7%	50.0%
Total Non-Interest Expense to Average Assets .....	3.9%	3.7%	3.8%

Non-interest expense increased \$2.0 million, or 8.5%, to \$25.8 million in 2007, from \$23.8 million in 2006. Non-interest expense increased 3.1% in 2006 and 4.6% in 2005. The increase in 2007 is largely due to a \$1.4 million increase in the legal and accounting expenses incurred due to the ALC loan irregularities. The legal and accounting expense increase represents 71.4% of the total non-interest expense increase. However, even with the increase, the ratio of non-interest expense to average assets remained stable during 2007 at 3.9%, compared to 3.7% in 2006 and 3.8% in 2005.

Total compensation and benefits decreased \$918,000, or 6.4%, in 2007, compared to an increase of 2.0% in 2006 and 9.1% in 2005. The decrease in 2007 is due mainly to decreased incentive awards and officer retirements. Incentive awards declined to \$928,000, a 49.1% decrease, from \$1.9 million in 2006, because the Bank failed to meet all of its performance objectives, and no incentives were awarded to ALC personnel for 2007. The Bank also experienced the retirement of four long-term officers during the first half of 2007. These officers were primarily replaced by promotions from within the Bank's staff. The Bank's health insurance plan increased 8.6%, to \$1.0 million, and was offset by a 2.2% decrease in the Company's sponsored employee stock ownership plan with 401(k) provisions. At December 31, 2007, and 2006, the Company had 286 full-time equivalent employees compared to 282 in 2005.

Occupancy expense increased over the past three years due to continued branch expansion by the Bank, branch renovations, and the effects of inflation on routine expenditures. Occupancy expense includes rents, depreciation, utilities, maintenance, insurance, taxes and other expenses associated with maintaining the nineteen banking offices and twenty-five ALC finance company offices. The Company utilizes both acquired and leased space in operating these locations. The Bank owns all of its banking offices with the exception of the Columbiana office, which is leased. Seven of the Bank's branch offices were renovated or had some major repairs in 2007. All ALC offices are leased (costs associated with operating lease agreements can be reviewed in detail in Note 17, "Operating Leases," in the "Notes to Consolidated Financial Statements" included in this Annual Report). Occupancy expense increased by 14.6%, 9.3%, and 3.6% for each of the years ended December 31, 2007, 2006, and 2005, respectively.

Furniture and equipment expense increased 2.4% in 2007, compared to 1.9% in 2006, and decreased 2.4% in 2005.

The Bank invests in limited partnerships that operate qualified affordable housing projects. These partnerships receive tax benefits in the form of tax deductions from operating losses and tax credits. Although the Bank accounts for these investments utilizing the cost method, management analyzes the Bank's investments in limited partnerships for potential impairment on an annual basis. The investment balances in these partnerships were \$2.0 million at December 31, 2007 and 2006, and \$2.2 million in 2005. Losses in these investments amounted to \$109,000, \$240,000, and \$357,000 for 2007, 2006, and 2005, respectively.

## Provision for Income Taxes

The Company recorded an income tax benefit of \$1,219,829 during the year ended December 31, 2007, as compared to an income tax expense of \$7,095,281 and \$5,579,032 for the years ending December 31, 2006 and 2005, respectively. The income tax benefit recorded during 2007 resulted from significant loan losses and related expenses recorded by ALC. The effective tax rate for 2007 was also affected by the amount of nontaxable income and low income housing tax credits recorded in 2007 as compared to 2006 and 2005. Management projects that the effective income rate in the near future will be approximately 33% of pre-tax income. The calculation of the income tax provision requires the use of estimates and judgments of management. As part of the Company's overall business strategy, management must take into account tax law and regulations that apply to specific tax issues faced by the Company in each year. This analysis includes an evaluation of the amount and timing of the realization of income tax assets or liabilities. Management closely monitors tax developments and evaluates the effect they may have on the Company's overall tax position. A more detailed discussion of the Company's provision for income taxes is included in Note 11, "Income Taxes," in the "Notes to Consolidated Financial Statements."

## Loans and Allowance for Loan Loss

Total loans outstanding decreased by \$13.1 million in 2007 with a loan portfolio totaling \$436.1 million as of December 31, 2007. For 2007, on an average basis, loans represent 74.8% of the Company's earning assets and provide 87.2% of the Company's interest income.

Real estate loans increased 2.5% to \$319.7 million in 2007. The Company's real estate loan portfolio is comprised of construction loans to both businesses and individuals for commercial and residential development, commercial buildings and apartment complexes, with most of this activity being commercial. Real estate loans also consist of other loans secured by real estate, such as one-to-four family dwellings, including mobile homes, loans on land only, multi-family dwellings, non-farm, non-residential real estate and home equity loans. As in previous years, quality real estate lending continues to be a priority of the Company's lending team and management. Real estate loans remain the largest component of the Company's loan portfolio comprising 73.3% of total loans outstanding.

Consumer loans represent the second largest component of the Company's loan portfolio. These loans include loans to individuals for household, family, and other personal expenditures, including credit cards and other related credit plans. Consumer loans at December 31, 2007, totaled \$82.5 million, compared to \$109.6 million the prior year. This represents a 24.8% decline. Consumer loans at ALC declined \$20.1 million, representing 74.0% of the total decline. The decline at ALC resulted from increased charge-offs as a result of the loan irregularities which occurred in the northern district of ALC. Tighter underwriting standards and enhanced controls put in place as a result of the irregularities also contributed to the decline in consumer loans at ALC.

Commercial, financial and agricultural loans increased by 16.4% during 2007 to \$40.6 million at December 31, 2007. The majority of this growth was in tax-exempt loans to municipalities and counties, which increased \$3.5 million over year-end 2006.

The allowance for loan losses is maintained at a level, which, in management's judgment, is adequate to absorb credit losses inherent in the loan portfolio. The amount of the allowance is based on management's evaluation of the collectibility of the loan portfolio, including the nature of the portfolio and changes in its risk profile, credit concentrations, historical trends, and economic conditions. This evaluation also considers the balance of impaired loans. Losses on individually identified impaired loans are measured based on the present value of expected future cash flows discounted at each loan's original effective market interest rate. As a practical expedient, impairment may be measured based on the loan's observable market price or the fair value of the collateral if the loan is collateral dependent. When the measure of the impaired loan is less than the recorded investment in the loan, the impairment is recorded through the provision added to the allowance for loan losses. Large pools of smaller balance, homogeneous loans are subjected to a collective evaluation for impairment, considering delinquency and repossession statistics, historical loss experience, and other factors. Though management believes the allowance for loan losses to be adequate, taking into consideration the views of regulators and the current economic environment, there can be no assurance that the allowance for loan losses is sufficient and ultimate losses may vary from their estimates. However, estimates are reviewed periodically, and as adjustments become necessary, they are reported in earnings during periods they become known.

The Bank's loan policy requires immediate recognition of a loss if significant doubt exists as to the repayment of the principal balance of a loan. Consumer installment loans at the Bank and ALC are generally recognized as losses if they

become 120 days delinquent. Exceptions are made particularly in loans that are secured by real estate and the borrower is in a repayment plan under the bankruptcy statutes. As long as these loans are paying in accordance with the bankruptcy plan, they are not charged-off.

A credit review of the Bank's individual loans is conducted periodically by branch and by loan officer. A risk rating is assigned to each loan and is reviewed at least annually. In assigning risk, management takes into consideration the capacity of the borrower to repay, collateral values, current economic conditions and other factors. Management also monitors the credit quality of the loan portfolio through the use of an outside comprehensive loan review.

Loan officers and other personnel handling loan transactions undergo frequent training dedicated to improving the credit quality as well as the yield of the loan portfolio. The Bank utilizes a written loan policy, which attempts to guide lending personnel in applying consistent underwriting standards. This policy is intended to aid loan officers and lending personnel in making sound credit decisions and to assure compliance with state and federal regulations. The Bank's loan policy is reviewed, at a minimum, on an annual basis to ensure timely modifications to the Bank's lending standards.

ALC's management oversees its loan portfolio through a loan committee, comprised of members of ALC's Board of Directors and ALC's district and office managers. It is aided by a formal loan policy, which has been revised and expanded as a direct result of the loan irregularities that occurred in the northern district of ALC. Other changes in ALC's organizational structure were made during 2007 to increase the number of personnel supervising ALC's operations. A new position of Chief Operating Officer ("COO"), who will report to the Chief Executive Officer of ALC, was created. At the present time, management is evaluating applicants for this important position and expects to fill it soon. The individual twenty-five branches are supervised by three district managers, who will report to the ALC COO.

The following table shows the Company's loan distribution as of December 31, 2007, 2006, 2005, 2004, and 2003.

	Year Ended December 31,				
	2007	2006	2005	2004	2003
	(In Thousands of Dollars)				
Commercial, Financial, and Agricultural .....	\$ 40,648	\$ 34,933	\$ 38,981	\$ 33,443	\$ 34,865
Real Estate .....	319,665	311,989	299,140	276,698	265,443
Installment (Consumer) .....	82,483	109,643	108,022	100,605	93,560
Less: Unearned Interest, Commissions, and Fees .....	6,673	7,326	6,922	6,763	7,290
Total .....	<u>\$436,123</u>	<u>\$449,239</u>	<u>\$439,221</u>	<u>\$403,983</u>	<u>\$386,578</u>

The amounts of total loans (excluding installment loans) outstanding at December 31, 2007, which, based on the remaining scheduled repayments of principal, are due in (1) one year or less, (2) more than one year but within five years, and (3) more than five years, are shown in the following table.

	Maturing			
	Within One Year	After One but Within Five Years	After Five Years	Total
	(In Thousands of Dollars)			
Commercial, Financial, and Agricultural .....	\$ 30,982	\$ 8,322	\$ 1,344	\$ 40,648
Real Estate-Mortgage .....	149,627	79,301	90,737	319,665
Total .....	<u>\$180,609</u>	<u>\$87,623</u>	<u>\$92,081</u>	<u>\$360,313</u>

Variable rate loans totaled approximately \$81.5 million and are included in the one-year category.

## Non-Performing Assets

Accruing loans past due 90 days or more at December 31, 2007, totaled \$5.2 million. These loans are secured, and, taking into consideration the collateral value and the financial strength of the borrowers, management believes there will be no loss in these accounts and has allowed the loans to continue accruing.

Impaired loans totaled \$15.7 million, \$7.3 million, and \$5.7 million as of December 31, 2007, 2006, and 2005, respectively. Impaired loans at December 31, 2007, consist mainly of ten commercial real estate loans and one commercial

loan. Based on management's analysis, these loans are considered impaired based on current collateral values. There was approximately \$1,624,648, \$847,676 and \$816,283 in the allowance for loan losses specifically allocated to these impaired loans at December 31, 2007, 2006, and 2005, respectively. The average recorded investment in impaired loans for 2007, 2006, and 2005 was approximately \$8.8 million, \$6.9 million, and \$2.5 million, respectively.

Non-performing assets as a percentage of net loans and other real estate was 4.8% at December 31, 2007, compared to 2.4% at December 31, 2006. This increase is due to an increase in real estate acquired in settlement of loans of \$9.8 million and loans past due 90 days or more of \$3.2 million, which are offset by a decrease of \$2.1 million in loans on non-accrual. Other real estate acquired as of December 31, 2007, consists of eight residential properties and eight commercial properties totaling \$6.7 million at the Bank and eighty-three residential properties totaling \$4.5 million at ALC. The increase at the Bank is due mainly to two large commercial properties totaling \$4.8 million. The increase at ALC is a result of the loan irregularities which occurred in the northern district of ALC and the adverse impact of the housing slowdown on this portion of the loan portfolio. Management is making considerable efforts to dispose of these properties in a timely manner, but the apparent slowdown in the housing market will have a negative impact on this process. Management believes by closely monitoring these loans, and through aggressive collection efforts, non-performing assets can be reduced. Management reviews these loans and reports to the Board of Directors monthly. Loans past due 90 days or more and still accruing are reviewed closely by management and are allowed to continue accruing only when underlying collateral values and management's belief that the financial strength of the borrowers are sufficient to protect the Bank from loss. If at any time management determines there may be a loss of interest or principal, these loans will be changed to non-accrual and their asset values downgraded.

The following table presents information on non-performing loans and real estate acquired in settlement of loans.

	December 31,				
	2007	2006	2005	2004	2003
	(In Thousands of Dollars)				
Non-Performing Assets:					
Loans Accounted for on a Non-Accrual Basis .....	\$ 5,253	\$ 7,318	\$5,662	\$1,496	\$1,879
Accruing Loans Past Due 90 Days or More .....	5,240	2,033	1,203	619	382
Real Estate Acquired in Settlement of Loans .....	11,156	1,318	1,750	1,664	2,608
Total .....	<u>\$21,649</u>	<u>\$10,669</u>	<u>\$8,615</u>	<u>\$3,779</u>	<u>\$4,869</u>
Non-Performing Assets as a Percent of Net					
Loans and Other Real Estate .....	<u>4.84%</u>	<u>2.37%</u>	<u>1.95%</u>	<u>0.93%</u>	<u>1.26%</u>

Summarized below is information concerning income on those loans with deferred interest or principal payments resulting from deterioration in the financial condition of the borrower.

	December 31,		
	2007	2006	2005
	(In Thousands of Dollars)		
Total Loans Accounted for on a Non-Accrual Basis .....	\$5,253	\$7,318	\$5,662
Interest Income that Would Have Been Recorded Under Original Terms .....	501	874	701
Interest Income Reported and Recorded During the Year .....	170	186	49

Accrual of interest is discontinued on a loan when management believes, after considering economic and business conditions and collection efforts, the borrower's financial condition is such that collection of interest is doubtful. In addition to consideration of these factors, the Company has a consistent and continuing policy of placing all loans on non-accrual status if they become 90 days or more past due, unless they are in the process of collection. When a loan is placed on non-accrual status, all interest which is accrued on the loan is reversed and deducted from earnings as a reduction of reported interest. No additional interest is accrued on the loan balance until collection of both principal and interest becomes reasonably certain. When a problem loan is finally resolved, there ultimately may be an actual write down or charge-off of the principal balance of the loan which would necessitate additional charges to the allowance for loan losses.

## Allocation of Allowance for Loan Losses

The following table shows an allocation of the allowance for loan losses for each of the five years indicated.

		December 31,									
		2007		2006		2005		2004		2003	
		Allocation Allowance	Percent of Loans in Each Category to Total Loans	Allocation Allowance	Percent of Loans in Each Category to Total Loans	Allocation Allowance	Percent of Loans in Each Category to Total Loans	Allocation Allowance	Percent of Loans in Each Category to Total Loans	Allocation Allowance	Percent of Loans in Each Category to Total Loans
(In Thousands of Dollars, Except Percentages)											
Commercial,											
Financial and											
Agricultural . . .		\$ 558	9%	\$ 376	8%	\$ 399	8%	\$ 385	8%	\$ 832	9%
Real Estate . . . . .		5,688	72	4,468	68	4,175	68	3,305	67	3,083	67
Installment . . . . .		2,289	19	2,820	24	3,120	24	3,371	25	2,927	24
Total . . . . .		<u>\$8,535</u>	<u>100%</u>	<u>\$7,664</u>	<u>100%</u>	<u>\$7,694</u>	<u>100%</u>	<u>\$7,061</u>	<u>100%</u>	<u>\$6,842</u>	<u>100%</u>

In establishing the allowance for loan losses, management created the following risk groups for evaluating the loan portfolio:

- Large classified loans and impaired loans are evaluated individually with specific reserves allocated based on management's review, consistent with FAS 114. As a result of the loan irregularities at ALC, management identified a group of smaller-balance consumer loans which were evaluated for impairment under FAS 114.
- The allowance for large pools of smaller-balance, homogeneous loans is based on such factors as changes in the nature and volume of the portfolio, overall portfolio quality, adequacy of the underlying collateral value, loan concentrations, historical charge-off trends, and economic conditions that may affect the borrowers' ability to pay, consistent with FAS 5.

Net charge-offs as shown in the "Summary of Loan Loss Experience" table below indicate the trend for the last five years.



## Summary of Loan Loss Experience

This table summarizes the Bank's loan loss experience for each of the five years indicated.

	December 31,				
	2007	2006	2005	2004	2003
	(In Thousands of Dollars)				
Balance of Allowance for Loan Loss at Beginning of Period	\$ 7,664	\$ 7,694	\$ 7,061	\$ 6,842	\$ 6,623
Charge-Offs:					
Commercial, Financial, and Agricultural	(483)	(473)	(238)	(317)	(959)
Real Estate-Mortgage	(5,414)	(241)	(183)	(690)	(198)
Installment	(15,715)	(4,001)	(3,559)	(3,243)	(2,935)
Credit Cards	(22)	(21)	(35)	(29)	(27)
	(21,634)	(4,736)	(4,015)	(4,279)	(4,119)
Recoveries:					
Commercial, Financial, and Agricultural	29	78	25	28	47
Real Estate-Mortgage	159	78	74	59	131
Installment	1,163	811	673	677	647
Credit Cards	2	13	23	10	8
	1,353	980	795	774	833
Net Charge-Offs	(20,281)	(3,756)	(3,220)	(3,505)	(3,286)
Provision for Loan Losses	21,152	3,726	3,853	3,724	3,505
Balance of Allowance for Loan Loss at End of Period	\$ 8,535	\$ 7,664	\$ 7,694	\$ 7,061	\$ 6,842
Ratio of Net Charge-Offs During Period to Average Loans					
Outstanding	4.53%	0.85%	0.77%	0.90%	0.90%

## Investment Securities Available-for-Sale and Derivative Instruments

Investment securities, which are classified as available-for-sale, include, as of December 31, 2007, U.S. Treasury securities of \$120,140, obligations of U.S. government sponsored agency securities of \$5.4 million, mortgage-backed securities of \$121.7 million, state, county, and municipal securities of \$16.6 million, and other securities of \$742,957. The securities portfolio is carried at fair market value, and increased \$24.8 million from December 31, 2006, to December 31, 2007.

Because of their liquidity, credit quality and yield characteristics, the majority of the purchases of taxable securities have been purchases of agency guaranteed mortgage-backed obligations and collateralized mortgage obligations ("CMOs"). The mortgage-backed obligations in which the Bank invests represent an undivided interest in a pool of residential mortgages or may be collateralized by a pool of residential mortgages ("mortgage-backed securities").

Mortgage-backed securities and CMOs present some degree of additional risk in that mortgages collateralizing these securities can be refinanced, thereby affecting the future yield and market value of the portfolio. Management expects the annual repayment of the underlying mortgages to vary as a result of monthly repayment of principal and/or interest required under terms of the underlying promissory notes. Further, the actual rate of repayment is subject to changes depending upon the terms of the underlying mortgages, the relative level of mortgage interest rates, and the structure of the securities. When relative interest rates decline to levels below that of the underlying mortgages, acceleration of principal repayment is expected as some borrowers on the underlying mortgages refinance to lower rates. When the underlying rates on mortgage loans are comparable to, or in excess of, market rates, repayment more closely conforms to scheduled amortization in accordance with terms of the promissory note with additional repayment as a result of sales of homes collateralizing the mortgage loans constituting the security. Although maturities of the underlying mortgage loans may range up to 30 years, scheduled principal and normal prepayments substantially shorten the average maturities.

Interest rate risk contained in the overall securities portfolio is formally monitored on a monthly basis. Management assesses each month how risk levels in the investment portfolio affect overall company-wide interest rate risk. Expected changes in forecasted yield, earnings, and market value of the bond portfolio are generally attributable to fluctuations in interest rates, as well as volatility caused by general uncertainty over the economy, inflation, and future interest rate trends.

The composition of the Bank's investment portfolio reflects the Bank's investment strategy of maximizing portfolio yields commensurate with risk and liquidity considerations. The primary objectives of the Bank's investment strategy are to maintain an appropriate level of liquidity and provide a tool to assist in controlling the Bank's interest rate position while at the same time producing adequate levels of interest income. As of December 31, 2007, the investment portfolio had an estimated average maturity of 3.4 years.

Fair market values of securities can vary significantly as interest rates change. The gross unrealized gains and losses in the securities portfolio are not expected to have a material impact on liquidity or other funding needs. There were net unrealized gains, net of tax, of \$867,500 in the securities portfolio on December 31, 2007, versus \$410,000 net unrealized losses, net of tax at year-end 2006.

The Bank has used certain derivative products for hedging purposes. These include interest rate swaps and caps. The use and detail regarding these products are fully discussed in the section entitled "Liquidity and Interest Rate Sensitivity Management" and in Note 2, "Summary of Significant Accounting Policies," in the "Notes to Consolidated Financial Statements" included in this Annual Report. The Bank adopted the provisions of Statement of Financial Accounting Standards No. 133, as amended ("FASB 133"), effective January 1, 2001, as required by the Financial Accounting Standards Board. On that date, the Bank reassessed and designated derivative instruments used for risk management as fair-value hedges, cash-flow hedges and derivatives not qualifying for hedge accounting treatment, as appropriate.

### Investment Securities Available-for-Sale

The following table sets forth the amortized costs of investment securities, as well as their fair value and related unrealized gains or losses on the dates indicated.

	December 31,		
	2007	2006	2005
	(In Thousands of Dollars)		
Investment Securities Available-for-Sale:			
U.S. Treasury and Government Sponsored Agency Securities	\$ 5,452	\$ 5,968	\$ 120
Obligations of States, Counties, and Political Subdivisions	16,273	16,451	17,006
Mortgage-Backed Securities	120,818	97,295	94,001
Other Securities	600	705	705
Total Book Value	143,143	120,419	111,832
Net Unrealized Gains (Losses)	1,388	(656)	(1,067)
Total Market Value	<u>\$144,531</u>	<u>\$119,763</u>	<u>\$110,765</u>

### Investment Securities Available-for-Sale Maturity Schedule

	Stated Maturity as of December 31, 2007							
	Within One Year		After One But Within Five Years		After Five But Within Ten Years		After Ten Years	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
	(In Thousands of Dollars, Except Yields)							
Investment Securities Available-for-Sale:								
U.S. Treasury and Government Sponsored Agency Securities	\$3,603	5.11%	\$ 0.00	0.00%	\$ 0.00	0.00%	\$ 1,899	8.19%
State, County, and Municipal Obligations	195	6.53	4,912	5.67	6,477	6.26	4,975	7.71
Mortgage-Backed Securities	1,424	0.00	4,500	5.14	30,488	4.80	85,315	5.34
Total	<u>\$5,222</u>	<u>3.77%</u>	<u>\$9,412</u>	<u>5.42%</u>	<u>\$36,965</u>	<u>5.06%</u>	<u>\$ 92,189</u>	<u>5.53%</u>
Total Securities With Stated Maturity							\$143,788	5.33%
Equity Securities							743	4.90
Total							<u>\$144,531</u>	<u>5.33%</u>

Available-for-sale securities are stated at market value and tax equivalent market yields.

## Condensed Portfolio Maturity Schedule

### Maturity Summary as of December 31, 2007

	Dollar Amount (In Thousands of Dollars)	Portfolio Percentage
Maturing in 3 months or less .....	\$ 100	0.07%
Maturing in greater than 3 months to 1 year .....	5,122	3.56
Maturing in greater than 1 to 3 years .....	3,390	2.36
Maturing in greater than 3 to 5 years .....	6,021	4.19
Maturing in greater than 5 to 15 years .....	68,089	47.35
Maturing in over 15 years .....	61,066	42.47
Total .....	<u>\$143,788</u>	<u>100.00%</u>

The following marketable equity securities have been excluded from the above maturity summary due to no stated maturity date.

Preferred Stock .....	\$468
Mutual Funds .....	10
Other Marketable Equity Securities .....	265

## Condensed Portfolio Repricing Schedule

### Repricing Summary as of December 31, 2007

	Dollar Amount (In Thousands of Dollars)	Portfolio Percentage
Repricing in 30 days or less .....	\$ 4,054	2.82%
Repricing in 31 days to 1 year .....	5,518	3.84
Repricing in greater than 1 to 3 years .....	14,368	9.99
Repricing in greater than 3 to 5 years .....	5,892	4.10
Repricing in greater than 5 to 15 years .....	77,522	53.91
Repricing in over 15 years .....	36,434	25.34
Total .....	<u>\$143,788</u>	<u>100.00%</u>

Repricing in 30 days or less does not include:

Mutual Funds .....	\$ 10
--------------------	-------

Repricing in 31 days to 1 year does not include:

Preferred Stock .....	468
Other Marketable Equity Securities .....	265

The tables above reflect all securities at market value on December 31, 2007.

## Security Gains and Losses

Non-interest income from securities transactions was a loss for years ended December 31, 2007, 2006, and 2005. Transactions affecting the Bank's investment portfolio are directed by the Bank's asset and liability management activities and strategies. Although short-term losses may occur from time to time, the "pruning" of the portfolio is designed to maintain the strength of the investment portfolio.

The table below shows the associated net losses for the periods 2007, 2006, and 2005.

	2007	2006	2005
Investment Securities .....	\$(107,156)	\$(268)	\$(37,232)

Volumes of sales, as well as other information regarding investment securities is discussed further in Note 3, "Investment Securities," in the "Notes to Consolidated Financial Statements" included in this Annual Report.

## Deposits

Core deposits, which exclude time deposits of \$100,000 or more, provide for a relatively stable funding source that supports earning assets. The Company's core deposits totaled \$366.3 million, or 76.5%, of total deposits at December 31, 2007, and totaled \$340.9 million, or 75.7%, of total deposits at December 31, 2006.

Deposits, in particular core deposits, have historically been the Company's primary source of funding and have enabled the Company to successfully meet both short-term and long-term liquidity needs. Management anticipates that such deposits will continue to be the Company's primary source of funding in the future, although economic and competitive factors could affect this funding source. The Company's loan-to-deposit ratio was 89.3% at December 31, 2007, and 98.1% at the end of 2006.

Time deposits in excess of \$100,000 grew 2.8% to \$112.2 million as of December 31, 2007. Included in these large deposits are \$20.9 million in brokered certificates of deposits at year-end 2007, compared with \$24.8 million at year-end 2006. Management has used brokered deposits as a funding source when rates and terms are more attractive than other funding sources.

The sensitivity of the Bank's deposit rates to changes in market interest rates is reflected in its average interest rate paid on interest-bearing deposits. During 2007, market interest rates increased, attributable to the movement toward higher yielding time deposits.

Management, as part of an overall program to emphasize the growth of transaction accounts, continues to promote online banking and an online bill paying program, as well as enhancing the telephone-banking product through the use of the employee incentive plan to reward personnel. In addition, continued effort is being placed on deposit promotions, direct-mail campaigns and cross-selling efforts.

## Average Daily Amount of Deposits and Rates

The average daily amount of deposits and rates paid on such deposits are summarized for the periods in the following table.

	December 31,					
	2007		2006		2005	
	Amount	Rate	Amount	Rate	Amount	Rate
(In Thousands of Dollars, Except Percentages)						
Non-Interest Bearing Demand Deposit Accounts . . . . .	\$ 64,472		\$ 66,191		\$ 62,237	
Interest-Bearing Demand Deposit Accounts . . . . .	75,873	0.83%	78,396	0.82%	80,295	0.79%
Savings Deposits . . . . .	47,721	1.06	52,487	0.95	57,246	0.94
Time Deposits . . . . .	291,873	4.92	246,199	4.29	217,888	3.21
Total . . . . .	<u>\$479,939</u>	<u>3.23%</u>	<u>\$443,273</u>	<u>2.64%</u>	<u>\$417,666</u>	<u>1.95%</u>

Maturities of time certificates of deposit and other time deposits of \$100,000 or more outstanding at December 31, 2007, are summarized as follows:

Maturities	Time Certificates of Deposit	Other Time Deposits	Total
3 Months or Less . . . . .	\$ 25,840,878	\$6,817,000	\$ 32,657,878
Over 3 Through 6 Months . . . . .	25,461,768	0	25,461,768
Over 6 Through 12 Months . . . . .	25,854,378	0	25,854,378
Over 12 Months . . . . .	28,254,047	0	28,254,047
Total . . . . .	<u>\$105,411,071</u>	<u>\$6,817,000</u>	<u>\$112,228,071</u>

## Other Borrowings

Other interest-bearing liabilities consist of federal funds purchased, securities sold under agreements to repurchase, treasury, tax and loan deposits, and Federal Home Loan Bank ("FHLB") advances. This category continues to be utilized as an alternative source of funds. During 2007, the average other interest-bearing liabilities represented 16.5% of the average total interest-bearing liabilities compared to 18.7% in 2006 and 20.6% in 2005. The advances from the FHLB are an alternative to funding sources with similar maturities such as certificates of deposit. These advances generally offer more attractive rates when compared to other mid-term financing options. Average federal funds purchased decreased from \$953,000 in 2006 to \$14,000 in 2007. Average treasury, tax, and loan deposits increased from \$629,000 in 2006 to \$727,000 in 2007. Securities sold under agreements to repurchase averaged \$17,903 in 2006, and \$230,000 in 2007. For additional information and discussion of these borrowings, refer to Notes 9 and 10, "Short-Term Borrowings" and "Long-Term Debt," respectively, in the "Notes to Consolidated Financial Statements" included in this Annual Report.

The following table shows information for the last three years regarding the Bank's short- and long-term borrowings consisting of treasury, tax, and loan deposits, federal funds purchases, securities sold under agreements to repurchase, and other borrowings from the FHLB.

	Short-Term Borrowings Maturity Less Than One Year	Long-Term Borrowings Maturity One Year or Greater
	(In Thousands of Dollars, Except Percentages)	
Year Ended December 31:		
2007 .....	\$11,212	\$77,518
2006 .....	1,757	87,553
2005 .....	1,248	89,588
Weighted Average Interest Rate at Year-End:		
2007 .....	4.39%	4.55%
2006 .....	5.04	5.34
2005 .....	3.96	4.50
Maximum Amount Outstanding at Any Month's End:		
2007 .....	\$11,551	\$87,544
2006 .....	11,443	89,579
2005 .....	7,719	89,621
Average Amount Outstanding During the Year:		
2007 .....	\$ 4,040	\$77,148
2006 .....	2,815	84,010
2005 .....	1,244	89,602
Weighted Average Interest Rate During the Year:		
2007 .....	5.10%	4.86%
2006 .....	5.15	4.93
2005 .....	3.60	4.01

## Shareholders' Equity

United Security has always placed great emphasis on maintaining its strong capital base. At December 31, 2007, shareholders' equity totaled \$79.6 million, or 12.1% of total assets, compared to 14.2% and 14.1% for year-end 2006 and 2005, respectively. This level of equity indicates to United Security's shareholders, customers and regulators that United Security is financially sound and offers the ability to sustain an appropriate degree of leverage to provide a desirable level of profitability and growth.

Over the last three years, shareholders' equity declined from \$81.9 million at the beginning of 2005 to \$79.6 million at the end of 2007. This reduction is the result of several factors. First, internally retained earnings were dramatically impaired by the losses sustained by ALC due to loan irregularities. Despite the reduction in retained earnings, the Company continued its dividend program in 2007. Additionally, the stock repurchase plan continued throughout 2007. Shareholder's equity also was impacted by the net change in unrealized gain (loss) on securities available-for-sale and derivatives, net of

tax, which decreased shareholder's equity by \$1.3 million in 2005, but increased shareholder's equity by \$109,817 and \$1.2 million in 2006 and 2007, respectively.

In connection with the United Security Bancshares, Inc. Non-Employee Directors' Deferred Compensation Plan, 2,608 shares were purchased in 2007 and 2,450 shares were purchased in 2006. The plan permits non-employee directors to invest their directors' fees and to receive the adjusted value of the deferred amounts in cash and/or shares of United Security common stock. For more information related to this plan see Note 13, "Long-Term Incentive Compensation Plan," in the "Notes to Consolidated Financial Statements" included in this Annual Report.

United Security initiated a share repurchase program in 2001 in which it authorized the Company to repurchase up to 1,429,204 shares of common stock (as adjusted for the two-for-one stock split that was effective June 30, 2003); however, no shares were repurchased under the program in 2003, 2004, or 2005. In January 2006, the Board of Directors terminated the repurchase program (which would have expired on June 30, 2006) and approved a new repurchase program, under which the Company was authorized to repurchase up to 642,785 shares of common stock before December 31, 2007. In December 2007 the Board of Directors extended the expiration date of the existing share repurchase program to December 31, 2008. During 2007, 219,052 shares were repurchased under this program for \$5.7 million, while 118,547 shares were purchased in 2006 for \$3.3 million.

Total cash dividends declared were \$7.3 million, or \$1.19, per share in 2007, compared to \$1.07 per share in 2006 and \$0.95 per share in 2005. The continuation of the strong dividend program in 2007, despite the losses at ALC, demonstrates the continued confidence the Board of Directors has in the Company. Calendar year 2007 is the nineteenth consecutive year that United Security has increased cash dividends.

United Security is required to comply with capital adequacy standards established by the Federal Reserve and the Federal Deposit Insurance Corporation. Currently, there are two basic measures of capital adequacy: a risk-based measure and a leverage measure. The risk-based capital standards are designed to make regulatory capital requirements more sensitive to differences in risk profile among banks and bank holding companies, to account for off-balance sheet exposure, and to minimize disincentives for holding liquid assets. Assets and off-balance sheet items are assigned to risk categories, each with a specified risk weight factor. The resulting capital ratios represent capital as a percentage of total risk-weighted assets and off-balance sheet items. The banking regulatory agencies also have adopted regulations which supplement the risk-based guidelines to include a minimum leverage ratio of 3% of Tier 1 Capital (as defined below) to total assets less goodwill (the "leverage ratio"). Depending upon the risk profile of the institution and other factors, the regulatory agencies may require a leverage ratio of 1% or 2% higher than the minimum 3% level.

The minimum standard for the ratio of total capital to risk-weighted assets is 8%. At least 50% of that capital level must consist of common equity, undivided profits, and non-cumulative perpetual preferred stock, less goodwill and certain other intangibles ("Tier 1 Capital"). The remainder ("Tier II Capital") may consist of a limited amount of other preferred stock, mandatory convertible securities, subordinated debt, and a limited amount of the allowance for loan losses. The sum of Tier 1 Capital and Tier II Capital is "total risk-based capital."

## Risk-Based Capital Requirements

	Minimum Regulatory Requirements	United Security's Ratio at December 31, 2007
Total Capital to Risk-Adjusted Assets .....	8.00%	17.67%
Tier I Capital to Risk-Adjusted Assets .....	4.00%	16.40%
Tier I Leverage Ratio .....	3.00%	11.43%

In addition to meeting the minimum regulatory ratios, the regulatory ratios of the Bank exceeded the ratios required for well-capitalized banks as defined by federal banking regulators. To be categorized as well-capitalized, the Bank must maintain Total Qualifying Capital, Tier I Capital and leverage ratios of at least 8%, 4%, and 3%, respectively.

## Ratio Analysis

The following table presents operating and equity performance ratios for each of the last three years.

	Year Ended December 31,		
	2007	2006	2005
Return on Average Assets .....	0.05%	2.24%	2.25%
Return on Average Equity .....	0.41%	16.05%	16.04%
Cash Dividend Payout Ratio .....	2,104.78%	47.89%	44.75%
Average Equity to Average Assets Ratio .....	12.96%	13.97%	14.01%

## Liquidity and Interest Rate Sensitivity Management

The primary functions of asset and liability management are to (1) assure adequate liquidity, (2) maintain an appropriate balance between interest-sensitive assets and interest-sensitive liabilities, (3) maximize the profit of the Bank and (4) reduce risks to the Bank's capital. Liquidity management involves the ability to meet day-to-day cash flow requirements of the Bank's customers, whether they are depositors wishing to withdraw funds or borrowers requiring funds to meet their credit needs. Without proper liquidity management, the Bank would not be able to perform the primary function of a financial intermediary and would, therefore, not be able to meet the needs of the communities it serves. Interest rate risk management focuses on the maturity structure of assets and liabilities and their repricing characteristics during changes in market interest rates. Effective interest rate sensitivity management ensures that both assets and liabilities respond to changes in interest rates within an acceptable time frame, thereby minimizing the effect of such interest rate movements on the net interest margin.

The asset portion of the balance sheet provides liquidity primarily from two sources. These are principal payments, maturities, and sales relating to loans and maturities and principal payments from the investment portfolio. Other short-term investments such as federal funds sold are additional sources of liquidity. Loans maturing or repricing in one year or less amounted to \$204.8 million at December 31, 2007.

Investment securities that are forecast to mature or reprice over the next twelve months total \$9.6 million, or 6.7% of the investment portfolio as of December 31, 2007. For comparison, principal payments on investment securities totaled \$31.0 million in 2007.

Although the majority of the securities portfolio has legal final maturities longer than 10 years, the entire portfolio consists of securities that are readily marketable and easily convertible into cash. As of December 31, 2007, the bond portfolio had an expected average maturity of 3.4 years, and only approximately 75.1% of the \$144.8 million in bonds were expected to be repaid within 5 years. However, management does not rely solely upon the investment portfolio to generate cash flows to fund loans, capital expenditures, dividends, debt repayment, and other cash requirements. Instead, these activities are funded by cash flows from operating activities and increases in deposits and short-term borrowings.

The liability portion of the balance sheet provides liquidity through interest-bearing and non-interest-bearing deposit accounts. Federal funds purchased, FHLB advances, securities sold under agreements to repurchase, and short-term and long-term borrowings are additional sources of liquidity. Liquidity management involves the continual monitoring of the sources and uses of funds to maintain an acceptable cash position. Long-term liquidity management focuses on considerations related to the total balance sheet structure.

The Bank, at December 31, 2007, had long-term debt and short-term borrowings that, on average, represented 12.3% of total liabilities and equity, compared to 13.7% at year-end 2006.

The Bank currently has up to \$110.1 million in additional borrowing capacity from the FHLB and \$25.0 million in established federal funds lines.

Interest rate sensitivity is a function of the repricing characteristics of the portfolio of assets and liabilities. These repricing characteristics are the time frames during which the interest-bearing assets and liabilities are subject to changes in interest rates, either at replacement or maturity, during the life of the instruments. Sensitivity is measured as the difference between the volume of assets and the volume of liabilities in the current portfolio that are subject to repricing in future time periods. These differences are known as interest sensitivity gaps and are usually calculated for segments of time and on a cumulative basis.

**Measuring Interest Rate Sensitivity:** Gap analysis is a technique used to measure interest rate sensitivity at a particular point in time, an example of which is presented below. Assets and liabilities are placed in gap intervals based on their repricing dates. Assets and liabilities for which no specific repricing dates exist are placed in gap intervals based on management's judgment concerning their most likely repricing behaviors. Interest rate derivatives used in interest rate sensitivity management also are included in the applicable gap intervals.

A net gap for each time period is calculated by subtracting the liabilities repricing in that interval from the assets repricing. A positive gap – more assets repricing than liabilities – will benefit net interest income if rates are rising and will detract from net interest income in a falling rate environment. Conversely, a negative gap – more liabilities repricing than assets – will benefit net interest income in a declining interest rate environment and will detract from net interest income in a rising interest rate environment.

Gap analysis is the simplest representation of the Bank's interest rate sensitivity. However, it cannot reveal the impact of factors such as administered rates, pricing strategies on consumer and business deposits, changes in balance sheet mix, or the effect of various options embedded in balance sheet instruments.

The accompanying table shows the Bank's interest rate sensitive position at December 31, 2007, as measured by gap analysis. Over the next 12 months approximately \$98.1 million more interest-bearing liabilities than interest-earning assets can be repriced to current market rates at least once. This analysis indicated that the Bank has a negative gap within the next 12-month range.

## Maturity and Repricing Report

December 31, 2007							
(In Thousands of Dollars, Except Percentages)							
	0-3 Months	4-12 Months	Total 1 Year or Less	1-5 Years	Over 5 Years	Non-Rate Sensitive	Total
<b>Earning Assets:</b>							
Loans (Net of Unearned Income) .....	\$128,182	\$ 76,625	\$204,807	\$ 137,370	\$ 93,946	\$ 0	\$436,123
Investment Securities .....	4,064	6,251	10,315	20,260	113,956	0	144,531
Federal Home Loan Bank Stock .....	5,096	0	5,096	0	0	0	5,096
Interest-Bearing Deposits in Other Banks .....	7,427	0	7,427	0	0	0	7,427
Total Earning Assets .....	\$144,769	\$ 82,876	\$227,645	\$ 157,630	\$207,902	\$ 0	\$593,177
Percent of Total Earning Assets .....	24.4%	14.0%	38.4%	26.6%	35.0%	0.0%	100.0%
<b>Interest-Bearing Liabilities:</b>							
Interest-Bearing Deposits and Liabilities							
Demand Deposits .....	\$ 16,186	\$ 0	\$ 16,186	\$ 64,742	\$ 0	\$ 0	\$ 80,928
Savings Deposits .....	9,339	0	9,339	37,357	0	0	46,696
Time Deposits .....	71,996	147,988	219,984	70,557	0	0	290,541
Borrowings .....	41,721	37,009	78,730	10,000	0	0	88,730
<b>Non-Interest-Bearing Liabilities:</b>							
Demand Deposits .....	1,510	0	1,510	0	0	58,879	60,389
Total Funding Sources .....	\$140,752	\$ 184,997	\$325,749	\$ 182,656	\$ 0	\$ 58,879	\$567,284
Percent of Total Funding Sources .....	24.8%	32.6%	57.4%	32.2%	0.0%	10.4%	100.0%
Interest-Sensitivity Gap (Balance Sheet) .....	\$ 4,017	\$(102,121)	\$(98,104)	\$ (25,026)	\$207,902	\$(58,879)	\$ 25,893
Derivative Instruments .....	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Interest-Sensitivity Gap .....	\$ 4,017	\$(102,121)	\$(98,104)	\$ (25,026)	\$207,902	\$(58,879)	\$ 25,893
Cumulative Interest-Sensitivity Gap .....	\$ 4,017	\$(98,104)	N/A	\$(123,130)	\$ 84,772	\$ 25,893	\$ 51,876
	0-3 Months	4-12 Months	Total 1 Year or Less	1-5 Years	Over 5 Years	Non-Rate Sensitive	Total
<b>Ratio of Earning Assets to Funding Sources and</b>							
Derivative Instruments .....	1.03%	0.45%	0.70%	0.86%		3.53%	1.00%
Cumulative Ratio .....	1.03%	0.70%	N/A	0.76%		1.05%	1.05%



## Assessing Short-Term Interest Rate Risk – Net Interest Margin Simulation

On a monthly basis, the Bank simulates how changes in short- and long-term interest rates will impact future profitability as reflected by changes in the Bank's net interest margin. The tables below depict how, as of December 31, 2007, pre-tax net interest margins and pre-tax net income are forecast to change over time frames of six months, one year, two years, and five years under the four listed interest rate scenarios. The interest rate scenarios are immediate and parallel shifts in short- and long-term interest rates.

### Average Change in Net Interest Margin from Level Interest Rate Forecast, (basis points, pre-tax):

	<u>6 Months</u>	<u>1 Year</u>	<u>2 Years</u>	<u>5 Years</u>
+1% .....	-3	-5	-5	-2
+2% .....	-7	-14	-17	-11
-1% .....	-5	-10	-16	-21
-2% .....	-16	-25	-36	-43

### Change in Net Interest Income from Level Interest Rate Forecast, (dollars, pre-tax):

	<u>6 Months</u>	<u>1 Year</u>	<u>2 Years</u>	<u>5 Years</u>
+1% .....	\$ (92,851)	\$ (337,190)	\$ (729,087)	\$ (619,252)
+2% .....	\$(238,571)	\$ (954,084)	\$(2,264,574)	\$ (3,543,403)
-1% .....	\$(166,605)	\$ (689,000)	\$(2,113,925)	\$ (6,922,721)
-2% .....	\$(532,011)	\$(1,679,064)	\$(4,799,155)	\$(14,332,612)

## Assessing Long-Term Interest Rate Risk – Market Value of Equity and Estimating Modified Durations for Assets and Liabilities

On a monthly basis, the Bank calculates how changes in interest rates would impact the market value of its assets and liabilities, as well as changes in long-term profitability. The process is similar to assessing short-term risk but is measured over a five-year time period which allows for a more comprehensive assessment of longer-term repricing and cash flow imbalances that may not be captured by short-term net interest margin simulation. The results of these calculations are representative of long-term interest rate risk, both in terms of changes in the present value of the Bank's assets and liabilities, as well as long-term changes in core profitability.

### Market Value of Equity and Estimated Modified Duration of Assets, Liabilities, and Equity Capital

	<u>+1%</u>	<u>+2%</u>	<u>-1%</u>	<u>-2%</u>
Asset Modified Duration .....	2.25%	2.27%	2.09%	2.05%
Liability Modified Duration .....	2.20%	2.04%	2.95%	2.98%
Modified Duration Mismatch .....	0.05%	0.23%	-0.86%	-0.93%
Estimated Change in Market Value of Equity (Pre-Tax) .....	\$(323,555)	\$(3,086,411)	\$(5,750,799)	\$(12,381,971)
Change in Market Value of Equity / Equity Capital (Pre-Tax) ..	-0.35%	-3.38%	-6.30%	-13.57%

## Contractual Obligations

The Company has contractual obligations to make future payments on debt and lease agreements. Long-term debt is reflected on the consolidated statements of financial condition, whereas, operating lease obligations for office space and equipment are not recorded on the Consolidated Statements of Financial Condition. The Company and its subsidiaries have not entered into any unconditional purchase obligations or other long-term obligations other than as included in the following table. These types of obligations are more fully discussed in Note 10, "Long-Term Debt," and Note 17, "Operating Leases," of the "Notes to Consolidated Financial Statements" included in this Annual Report.

Many of the Bank's lending relationships, including those with commercial and consumer customers, contain both funded and unfunded elements. The unfunded component of these commitments is not recorded in the Consolidated Statements of Financial Condition. These commitments are more fully discussed in Note 18, "Guarantees, Commitments, and Contingencies," of the "Notes to Consolidated Financial Statements" included in this Annual Report.

The following summarizes the Company's contractual obligations as of December 31, 2007.

	Payment Due by Period				
	(In Thousands of Dollars)				
	Total	Less Than One Year	One to Three Years	Three to Five Years	More than Five Years
Time Deposits .....	\$290,541	\$219,984	\$44,411	\$26,146	\$ 0
Long-Term Debt* .....	77,518	7,518	50,000	20,000	0
Commitments to Extend Credit .....	47,275	43,143	0	0	4,132
Operating Leases .....	822	368	409	45	0
Standby Letters of Credit .....	620	520	100	0	0
Total .....	<u>\$416,776</u>	<u>\$271,533</u>	<u>\$94,920</u>	<u>\$46,191</u>	<u>\$4,132</u>

\* Long-term debt consists of FHLB advances totaling \$77.5 million. \$57.0 million are fixed-rate advances, and \$20.5 million are convertible. Interest is included and calculated at the current rate for the entire period.

## Off-Balance Sheet Obligations

The Company does not have any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on its financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that are considered material, other than "Operating Leases," included in Note 17, "Guarantees, Commitments, and Contingencies," included in Note 18, and "Derivative Financial Instruments," included in Note 19 of the "Notes to Consolidated Financial Statements" included in this Annual Report.

## Management's Report on Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934). Bancshares' internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Bancshares' internal control over financial reporting includes those policies and procedures that:

- (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of Bancshares;
- (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of Bancshares are being made only in accordance with authorizations of management and directors of Bancshares; and
- (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of Bancshares' assets that could have a material effect on the financial statements.

Management assessed the effectiveness of Bancshares' internal control over financial reporting as of December 31, 2007. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework. A material weakness is a significant deficiency (within the meaning of PCAOB Auditing Standard No. 5), or combination of significant deficiencies, that results in there being more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected on a timely basis by employees in the normal course of their assigned functions. In connection with management's assessment of Bancshares' internal control over financial reporting described above, management has identified a material weakness in Bancshares' internal control over financial reporting relating to the

system of monitoring the real estate collateral values of certain impaired loans at the Bank's ALC subsidiary. In certain instances, management had not identified a loss position on a timely basis for impaired loans, based on the current fair market value of the underlying real estate collateral for such loans.

Because of the material weakness described above, based on its assessment, management believes that, as of December 31, 2007, Bancshares did not maintain effective internal control over financial reporting based on the criteria established in Internal Control – Integrated Framework, issued by COSO.

To remediate the material weakness in Bancshares' internal control over financial reporting described above, additional procedures have been implemented to reinforce the requirement that once a loan meets the impairment criteria, such loan is deemed impaired and the amount of the impairment is based on the current appraisal of the collateral securing that loan. Management has discussed this corrective action with the Audit Committee of Bancshares and with its auditors, Mauldin & Jenkins, LLC ("Mauldin & Jenkins"). The Company believes that its consolidated financial statements included in the Annual Report on Form 10-K fairly present, in all material respects, Bancshares' financial condition, results of operations and cash flows as of, and for, the periods presented.

Mauldin & Jenkins, under Auditing Standard No. 5, does not express an opinion on management's assessment as required under Auditing Standard No. 2. Under Auditing Standard No. 5, management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Mauldin & Jenkins' responsibility is to express an opinion on the effectiveness of Bancshares' internal control over financial reporting based on their audit.

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors  
United Security Bancshares, Inc.  
Thomasville, Alabama

We have audited **United Security Bancshares, Inc.**'s internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). United Security Bancshares Inc. and Subsidiaries' management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

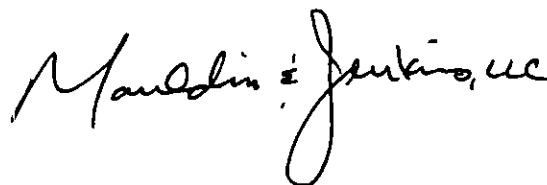
A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis. The following material weakness has been identified and included in management's assessment: a material weakness in the controls over financial reporting relating to the system of monitoring the real estate collateral values of certain impaired loans at Acceptance Loan Company, Inc., a subsidiary of United Security Bancshares, Inc. In certain instances, management has not identified a loss position on a timely basis for impaired loans, based on the current fair market value of the underlying real estate collateral for such loans. This material weakness was considered in determining the nature, timing, and extent of audit tests applied in our audit of the 2007 financial statements, and this report does not affect our report dated March 11, 2008 on those financial statements.

In our opinion, because of the effect of the material weakness described above on the achievement of the objectives of the control criteria, United Security Bancshares Inc., has not maintained effective internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)."

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of United Security Bancshares, Inc. and Subsidiaries as of December 31, 2007 and 2006, and the related consolidated statements of income, changes in stockholders' equity and comprehensive income and cash flows for each of the three years then ended and our report dated March 11, 2008 expressed an unqualified opinion.



Birmingham, Alabama  
March 11, 2008

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors  
United Security Bancshares, Inc.  
Thomasville, Alabama

We have audited the accompanying consolidated balance sheets of **United Security Bancshares, Inc. and Subsidiaries** as of December 31, 2007 and 2006 and the related consolidated statements of income, comprehensive income, stockholders' equity and cash flows for each of the three years ended December 31, 2007. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of United Security Bancshares, Inc. and Subsidiaries as of December 31, 2007 and 2006 and the results of their operations and their cash flows for each of the three years ended, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), United Security Bancshares, Inc. and subsidiaries' internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Our report dated March 11, 2008, expressed an opinion that United Security Bancshares, Inc. and subsidiaries' had not maintained effective internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).



Birmingham, Alabama  
March 11, 2008

**UNITED SECURITY BANCSHARES, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CONDITION**

DECEMBER 31, 2007 AND 2006

	2007	2006
<b>ASSETS</b>		
CASH AND DUE FROM BANKS .....	\$ 13,247,004	\$ 14,668,283
INTEREST-BEARING DEPOSITS IN OTHER BANKS .....	7,427,375	13,791,366
Total cash and cash equivalents .....	20,674,379	28,459,649
FEDERAL FUNDS SOLD .....	0	25,000
INVESTMENT SECURITIES AVAILABLE-FOR-SALE, at fair market value .....	144,531,425	119,763,324
FEDERAL HOME LOAN BANK STOCK, at cost .....	5,095,700	5,179,900
LOANS, net of allowance for loan losses of \$8,535,230, and \$7,664,432, respectively .....	427,587,854	441,574,169
PREMISES AND EQUIPMENT, net of accumulated depreciation of \$16,568,935 and \$15,593,276, respectively .....	18,131,913	18,864,475
CASH SURRENDER VALUE OF BANK-OWNED LIFE INSURANCE .....	10,945,726	10,530,690
ACCRUED INTEREST RECEIVABLE .....	6,141,413	6,095,539
GOODWILL .....	4,097,773	4,097,773
INVESTMENT IN LIMITED PARTNERSHIPS .....	2,037,449	2,010,942
OTHER ASSETS .....	20,652,486	9,694,871
TOTAL ASSETS .....	<u>\$659,896,118</u>	<u>\$646,296,332</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>DEPOSITS:</b>		
Demand, non-interest-bearing .....	\$ 60,389,475	\$ 62,044,974
Demand, interest-bearing .....	80,927,762	76,712,623
Savings .....	46,695,806	47,463,110
Time, \$100,000 and over .....	112,228,071	109,140,169
Other time .....	178,313,093	154,701,580
Total deposits .....	478,554,207	450,062,456
ACCRUED INTEREST EXPENSE .....	3,935,822	3,169,744
OTHER LIABILITIES .....	9,107,990	12,158,963
SHORT-TERM BORROWINGS .....	11,211,949	1,756,988
LONG-TERM DEBT .....	77,517,544	87,552,632
TOTAL LIABILITIES .....	<u>580,327,512</u>	<u>554,700,783</u>
<b>SHAREHOLDERS' EQUITY:</b>		
Common stock, par value \$.01 per share; 10,000,000 shares authorized; 7,317,560 shares issued .....	73,175	73,175
Surplus .....	9,233,279	9,233,279
Accumulated other comprehensive income (loss), net of tax .....	875,257	(274,910)
Retained earnings .....	89,347,955	96,712,701
Treasury stock, 1,232,368 and 1,010,708 shares at cost for 2007 and 2006, respectively ..	(19,961,060)	(14,148,696)
TOTAL SHAREHOLDERS' EQUITY .....	<u>79,568,606</u>	<u>91,595,549</u>
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY .....	<u>\$659,896,118</u>	<u>\$646,296,332</u>

The accompanying notes are an integral part of these consolidated statements.

# UNITED SECURITY BANCSHARES, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF INCOME

FOR THE YEARS ENDED DECEMBER 31, 2007, 2006, AND 2005

	2007	2006	2005
INTEREST INCOME:			
Interest and fees on loans	\$52,317,215	\$52,630,344	\$46,914,359
Interest on investment securities available-for-sale:			
Taxable	5,701,346	5,100,628	4,379,747
Tax-exempt	731,870	760,312	871,292
Other interest and dividends	1,232,343	728,054	514,010
Total interest income	59,982,774	59,219,338	52,679,408
INTEREST EXPENSE:			
Interest on deposits	15,497,470	11,691,855	8,162,144
Interest on short-term borrowings	206,059	144,942	44,819
Interest on long-term debt	3,760,576	4,155,053	3,603,305
Total interest expense	19,464,105	15,991,850	11,810,268
NET INTEREST INCOME	40,518,669	43,227,488	40,869,140
PROVISION FOR LOAN LOSSES	21,152,274	3,725,974	3,853,052
Net interest income after provision for loan losses	19,366,395	39,501,514	37,016,088
NON-INTEREST INCOME:			
Service and other charges on deposit accounts	3,279,592	3,146,615	2,941,213
Credit life insurance income	700,587	825,689	769,648
Investment securities losses, net	(107,156)	(268)	(37,232)
Other income	1,693,326	1,648,576	1,604,363
Total non-interest income	5,566,349	5,620,612	5,277,992
NON-INTEREST EXPENSE:			
Salaries and employee benefits	13,508,112	14,425,832	14,146,283
Furniture and equipment expense	1,396,461	1,363,709	1,338,226
Occupancy expense	1,943,001	1,695,795	1,551,365
Other expense	8,956,375	6,296,968	6,023,121
Total non-interest expense	25,803,949	23,782,304	23,058,995
INCOME (LOSS) BEFORE INCOME TAXES	(871,205)	21,339,822	19,235,085
PROVISION FOR (BENEFIT FROM) INCOME TAXES	(1,219,829)	7,095,281	5,579,032
NET INCOME	\$ 348,624	\$14,244,541	\$13,656,053
AVERAGE NUMBER OF SHARES OUTSTANDING	6,174,473	6,367,232	6,428,287
BASIC AND DILUTED EARNINGS PER SHARE	\$ 0.06	\$ 2.24	\$ 2.12
DIVIDENDS PER SHARE	\$ 1.19	\$ 1.07	\$ .95

The accompanying notes are an integral part of these consolidated statements.

**UNITED SECURITY BANCSHARES, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**  
FOR THE YEARS ENDED DECEMBER 31, 2007, 2006, AND 2005

	Common Stock	Surplus	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Treasury Stock, at Cost	Total Shareholders' Equity
BALANCE, December 31, 2004 .....	\$73,175	\$9,233,279	\$ 946,715	\$82,458,712	\$(10,799,004)	\$81,912,877
Net income .....	0	0	0	13,656,053	0	13,656,053
Other comprehensive loss .....	0	0	(1,331,442)	0	0	(1,331,442)
Dividends paid .....	0	0	0	(6,110,660)	0	(6,110,660)
Purchase of treasury stock .....	0	0	0	0	(78,379)	(78,379)
Minority interest .....	0	0	0	(339,219)	0	(339,219)
BALANCE, December 31, 2005 .....	73,175	9,233,279	(384,727)	89,664,886	(10,877,383)	87,709,230
Net income .....	0	0	0	14,244,541	0	14,244,541
Other comprehensive income .....	0	0	109,817	0	0	109,817
Dividends paid .....	0	0	0	(6,821,709)	0	(6,821,709)
Purchase of treasury stock .....	0	0	0	0	(3,271,313)	(3,271,313)
Minority interest .....	0	0	0	(375,017)	0	(375,017)
BALANCE, December 31, 2006 .....	73,175	9,233,279	(274,910)	96,712,701	(14,148,696)	91,595,549
Net income .....	0	0	0	348,624	0	348,624
Other comprehensive income .....	0	0	1,150,167	0	0	1,150,167
Dividends paid .....	0	0	0	(7,337,794)	0	(7,337,794)
Purchase of treasury stock .....	0	0	0	0	(5,812,364)	(5,812,364)
Minority interest .....	0	0	0	(375,576)	0	(375,576)
BALANCE, December 31, 2007 .....	<u>\$73,175</u>	<u>\$9,233,279</u>	<u>\$ 875,257</u>	<u>\$89,347,955</u>	<u>\$(19,961,060)</u>	<u>\$79,568,606</u>

The accompanying notes are an integral part of these consolidated statements.



**UNITED SECURITY BANCSHARES, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

FOR THE YEARS ENDED DECEMBER 31, 2007, 2006, AND 2005

	<u>2007</u>	<u>2006</u>	<u>2005</u>
Net Income .....	\$ 348,624	\$14,244,541	\$13,656,053
Other comprehensive income (loss):			
Change in unrealized holding (losses) gains for derivatives arising during period, net of tax (benefit) of (\$7,594), and \$111,625, respectively .....	0	(12,657)	186,626
Reclassification adjustment for net gains realized on derivatives in net income, net of taxes of \$76,240, \$80,632 and \$60,474, respectively .....	(127,065)	(134,387)	(100,790)
Change in unrealized holding gains (losses) on available-for-sale securities arising during period, net of tax (benefits) of \$726,156, \$154,016, and (\$864,329), respectively .....	1,210,260	256,694	(1,440,548)
Reclassification adjustment for net losses realized on available-for-sale securities realized in net income, net of benefits of \$40,184, \$101, and \$13,962, respectively .....	66,972	167	23,270
Other comprehensive income (loss) .....	<u>1,150,167</u>	<u>109,817</u>	<u>(1,331,442)</u>
Comprehensive income .....	<u>\$1,498,791</u>	<u>\$14,354,358</u>	<u>\$12,324,611</u>

The accompanying notes are an integral part of these consolidated statements.

# UNITED SECURITY BANCSHARES, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED DECEMBER 31, 2007, 2006, AND 2005

	2007	2006	2005
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net income	\$ 348,624	\$ 14,244,541	\$ 13,656,053
Adjustments to reconcile net income to cash provided by operating activities:			
Depreciation	953,871	957,428	931,272
Provision for loan losses	21,152,274	3,725,974	3,853,052
Deferred income tax benefit	(527,584)	(69,229)	(997,561)
Loss on sale of securities, net	107,156	268	37,232
Loss (gain) on sale of fixed assets, net	5,765	(184)	(109,762)
(Accretion) amortization of premium and discounts, net	(161,769)	30,211	295,234
Changes in assets and liabilities:			
Increase in accrued interest receivable	(45,875)	(885,323)	(561,148)
Increase in other assets	1,342,912	(694,846)	(2,678,936)
Increase in interest payable	766,078	735,441	536,157
(Decrease) increase in other liabilities	(4,312,214)	(420,707)	3,679,440
Net cash provided by operating activities	19,629,238	17,623,574	18,641,033
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Purchase of investment securities available-for-sale	(65,430,694)	(38,972,883)	(23,637,780)
Purchase of FHLB stock	(898,800)	(745,100)	0
Proceeds from sales of investment securities available-for-sale	5,188,759	17,433	5,430,624
Proceeds from maturities and prepayments of securities available-for-sale	37,572,019	30,337,595	27,360,525
Purchase of cash surrender value life insurance	0	0	(950,000)
Proceeds from redemption of FHLB stock	983,000	768,000	0
Net change in loan portfolio	(19,139,296)	(13,649,784)	(38,344,491)
Net decrease (increase) in federal funds sold	25,000	(25,000)	0
Purchase of premises and equipment, net	(475,994)	(645,369)	(671,308)
Net cash and income acquired in consolidation of limited partnerships	32	(13,590)	(73,476)
Net cash used in investing activities	(42,175,974)	(22,928,698)	(30,885,906)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Net increase in customer deposits	28,491,751	23,831,793	25,779,772
Net increase in short-term borrowings	9,454,961	508,621	306,869
Proceeds from FHLB advances and other borrowings	67,000,000	45,000,000	50,000,000
Repayment of FHLB advances and other borrowings	(77,035,088)	(47,035,087)	(50,048,977)
Dividends paid	(7,337,794)	(6,821,709)	(6,110,660)
Purchase of treasury stock	(5,812,364)	(3,271,313)	(78,379)
Net cash provided by financing activities	14,761,466	12,212,305	19,848,625
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>			
<b>NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS</b>	(7,785,270)	6,907,181	7,603,752
<b>CASH AND CASH EQUIVALENTS, beginning of year</b>	28,459,649	21,552,468	13,948,716
<b>CASH AND CASH EQUIVALENTS, end of year</b>	<u>\$ 20,674,379</u>	<u>\$ 28,459,649</u>	<u>\$ 21,552,468</u>

The accompanying notes are an integral part of these consolidated statements.

# UNITED SECURITY BANCSHARES, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2007, 2006, AND 2005

### 1. DESCRIPTION OF BUSINESS

United Security Bancshares, Inc. (the "Company" or "USB") and its subsidiary, First United Security Bank (the "Bank" or "FUSB"), provide commercial banking services to customers located primarily in Clarke, Choctaw, Bibb, Shelby, Tuscaloosa, and surrounding counties in Alabama and Mississippi. The Company also owns all of the stock of First Security Courier Corporation ("FSCC"), an Alabama corporation. FSCC is a courier service organized to transport items for processing to the Federal Reserve for financial institutions located in Southwest Alabama.

The Bank owns all of the stock of Acceptance Loan Company, Inc. ("Acceptance" or "ALC"), an Alabama corporation. Acceptance is a finance company organized for the purpose of making consumer loans and purchasing consumer loans from vendors. Acceptance has offices located within the communities served by the Bank as well as offices outside the Bank's market area in Alabama and Southeast Mississippi. The Bank also owns all of the stock of FUSB Reinsurance, Inc. ("Reinsurance"), an Arizona corporation. Reinsurance is an insurance company that was created to underwrite credit life and accidental death insurance related to loans written by the Bank and ALC. The Bank also invests in limited partnerships that operate qualified affordable housing projects to receive tax benefits. The Bank also owns all of the stock of R2Metrics, Inc. ("R2Metrics"), an Alabama corporation, which was incorporated in April 2007. R2Metrics provides investment and asset and liability management software, analytics, and consulting services for the Bank as well as other clients, and is located in Birmingham, Alabama.

### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### Principles of Consolidation

The consolidated financial statements include the accounts of the Company, FSCC, the Bank and its wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated. The Company considers a voting entity to be a subsidiary and consolidates if the Company has controlling financial interest in the entity. Variable Interest Entities (VIE's) are consolidated if the majority of the expected losses or returns would be absorbed by the Company. Unconsolidated investments in VIE's in which the Company has significant influence over operating and financing decisions are accounted for using the equity method. See Note 7 for further discussions of VIE's.

#### Use of Estimates

The accounting principles and reporting policies of the Company, and the methods of applying these principles, conform with accounting principles generally accepted in the United States ("GAAP") and with general practices within the financial services industry. In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the statements of condition and revenues and expenses for the period. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant changes in the near term relate to the determination of the allowance for loan losses and the valuation of real estate acquired in connection with foreclosures or in satisfaction of loans. In connection with the determination of the allowances for loan losses and real estate owned, in some cases, management obtains independent appraisals for significant properties, evaluates the overall portfolio characteristics and delinquencies, and monitors economic conditions.

A substantial portion of the Company's loans is secured by real estate in its primary market area. Accordingly, the ultimate collectibility of a substantial portion of the Company's loan portfolio and the recovery of a portion of the carrying amount of foreclosed real estate are susceptible to changes in economic conditions in the Company's primary market.

#### Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash on hand and amounts due from banks. The Company is required to maintain clearing balances at the Federal Reserve Bank. The average amount of this clearing balance was \$25,000 for both years ended December 31, 2007, and 2006.

# UNITED SECURITY BANCSHARES, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(CONTINUED)

Supplemental disclosures of cash flow information and non-cash transactions related to cash flows for the years ended December 31, 2007, 2006, and 2005 are as follows:

	2007	2006	2005
Cash paid during the period for:			
Interest .....	\$18,698,027	\$15,256,409	\$11,274,111
Income taxes .....	3,999,642	7,107,485	6,888,833
Non-Cash Transactions:			
Other Real Estate Acquired in Settlement of Loans .....	12,106,416	1,644,591	486,597

### Revenue Recognition

The main source of revenue for the Company is interest revenue, which is recognized on an accrual basis calculated by non-discretionary formulas based on written contracts, such as loan agreements or securities contracts. Loan origination fees are amortized into interest income over the term of the loan. Other types of non-interest revenue such as service charges on deposits are accrued and recognized into income as services are provided and the amount of fees earned is reasonably determinable.

### Securities

Securities may be held in three portfolios: trading account securities, held-to-maturity securities, and securities available-for-sale. Trading account securities are carried at market value, with unrealized gains and losses included in earnings. Investment securities held-to-maturity are carried at cost, adjusted for amortization of premiums and accretion of discounts. With regard to investment securities held-to-maturity, management has the intent and the Bank has the ability to hold such securities until maturity. Investment securities available-for-sale are carried at market value, with any unrealized gains or losses excluded from earnings and reflected, net of tax, as a separate component of shareholders' equity in accumulated other comprehensive income. Investment securities available-for-sale are so classified because management may decide to sell certain securities prior to maturity for liquidity, tax planning, or other valid business purposes. The Company held no securities in its held-to-maturity portfolio or trading account at December 31, 2007, or 2006. Equity securities are classified as available-for-sale and recorded at fair market value.

Interest earned on investment securities available-for-sale is included in interest income. Amortization of premiums and discounts on investment securities is determined by the interest method. Gains and losses on the sale of investment securities available-for-sale, computed principally on the specific identification method, are shown separately in non-interest income in the Consolidated Statements of Income.

### Derivatives and Hedging Activities

As part of the Company's overall interest rate risk management, the Company uses derivative instruments, which can include interest rate swaps, caps, and floors. Statements of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended (Statement 133), requires all derivative instruments to be carried at fair value on the statement of condition. Statement 133 provides special accounting provisions for derivative instruments that qualify for hedge accounting. To be eligible, the Company must specifically identify a derivative as a hedging instrument and identify the risk being hedged. The derivative instrument must be shown to meet specific requirements under Statement 133.

The Company designates the derivative on the date the derivative contract is entered into as (1) a hedge of the fair value of a recognized asset or liability or of an unrecognized firm commitment ("fair-value" hedge) or (2) a hedge of a forecasted transaction of the variability of cash flows to be received or paid related to a recognized asset or liability ("cash-flow" hedge). Changes in the fair value of a derivative that is highly effective as and that is designated and qualifies as a fair-value hedge, along with the loss or gain on the hedged asset or liability that is attributable to the hedged risk (including losses or gains on firm commitments), are recorded in current-period earnings. The effective portion of the changes in the fair value of a derivative that is highly effective as and that is designated and qualifies as a cash-flow hedge is recorded in other comprehensive income, until earnings are affected by the variability of cash flows (e.g., when periodic settlements on a variable-rate asset or liability are recorded in earnings). The remaining gain or

## UNITED SECURITY BANCSHARES, INC. AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(CONTINUED)

loss on the derivative, if any, in excess of the cumulative change in the present value of future cash flows of the hedged item is recognized in earnings.

The Company formally documents all relationships between hedging instruments and hedged items, as well as its risk-management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives that are designated as fair-value or cash-flow hedges to specific assets and liabilities on the balance sheet or to specific firm commitments or forecasted transactions. The Company also formally assessed, both at the hedge's inception and on an ongoing basis (if the hedges do not qualify for short-cut accounting), whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items. When it is determined that a derivative is not highly effective as a hedge or that it has ceased to be a highly effective hedge, the Company discontinues hedge accounting prospectively, as discussed below. The Company discontinues hedge accounting prospectively when: (1) it is determined that the derivative is no longer effective in offsetting changes in the fair value or cash flows of a hedged item (including firm commitments or forecasted transactions); (2) the derivative expires or is sold, terminated, or exercised; (3) the derivative is redesignated as a hedge instrument, because it is unlikely that a forecasted transaction will occur; (4) a hedged firm commitment no longer meets the definition of a firm commitment; or (5) management determines that designation of the derivative as a hedge instrument is no longer appropriate.

When hedge accounting is discontinued because it is determined that the derivative no longer qualifies as an effective fair-value hedge, hedge accounting is discontinued prospectively and the derivative will continue to be carried on the balance sheet at its fair value with all changes in fair value being recorded in earnings but with no offsetting being recorded on the hedged item or in other comprehensive income for cash-flow hedges.

#### **Loans and Interest Income**

Loans are reported at principal amounts outstanding, adjusted for unearned income, deferred loan origination fees and costs, purchase premiums and discounts, write-downs, and the allowance for loan losses. Loan origination fees, net of certain deferred origination costs, and purchase premiums and discounts are recognized as an adjustment to yield of the related loans, on an effective yield basis.

Interest on all loans is accrued and credited to income based on the principal amount outstanding.

The accrual of interest on loans is discontinued when, in the opinion of management, there is an indication that the borrower may be unable to meet payments as they become due. Upon such discontinuance, all unpaid accrued interest is reversed against current income unless the collateral for the loan is sufficient to cover the accrued interest. Interest received on non-accrual loans generally is either applied against principal or reported as interest income, according to management's judgment as to the collectibility of principal. Generally, loans are restored to accrual status when the obligation is brought current and has performed in accordance with the contractual terms for a reasonable period of time and the ultimate collectibility of the total contractual principal and interest is no longer in doubt.

#### **Allowance for Loan Losses**

The allowance for loan losses is determined based on various components in accordance with Statement of Financial Accounting Standards No. 114 *Accounting by Creditors for Impairment of a Loan* for individually impaired loans and Statement of Financial Accounting Standards No. 5 *Accounting for Contingencies* for pools of loans. The allowance for loan losses is increased by a provision for loan losses, which is charged to expense, and reduced by charge-offs, net of recoveries. The allowance for loan losses is maintained at a level, which, in management's judgment, is adequate to absorb credit losses inherent in the loan portfolio. The amount of the allowance is based on management's evaluation of the collectibility of the loan portfolio, including the nature of the portfolio, and changes in its risk profile, credit concentrations, historical trends, and economic conditions. This evaluation also considers the balance of impaired loans. Losses on individually identified impaired loans are measured based on the present value of expected future cash flows discounted at each loan's original effective market interest rate. As a practical expedient, impairment may be measured based on the loan's observable market price or the fair value of the collateral if the loan is collateral dependent. When the measure of the impaired loan is less than the recorded investment in the loan, the impairment is

# UNITED SECURITY BANCSHARES, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(CONTINUED)

recorded through the provision added to the allowance for loan losses. One-to-four family residential mortgages and consumer installment loans are subjected to a collective evaluation for impairment, considering delinquency and repossession statistics, historical loss experience, and other factors. Though management believes the allowance for loan losses to be adequate, ultimate losses may vary from their estimates. However, estimates are reviewed periodically, and as adjustments become necessary, they are reported in earnings during periods they become known.

### Long-Lived Assets

Premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed using the straight-line and accelerated methods over the estimated useful lives of the assets. Goodwill and core deposit intangibles are included in other assets. The Company adopted SFAS No. 142, *Goodwill and Other Intangible Assets*, which addresses how intangible assets that are acquired individually or with a group of assets should be accounted for in financial statements upon their acquisition. The statement also requires companies to no longer amortize goodwill and intangible assets with indefinite useful lives, but instead test annually for impairment. The Company had upon adoption of this statement \$4.1 million in unamortized goodwill and, in accordance with this statement, performed a transition impairment test and an annual impairment analysis and concluded that no impairment charge was needed.

### Other Real Estate

Other real estate consists of properties acquired through a foreclosure proceeding or acceptance of a deed in lieu of foreclosure. These properties are carried at the lower of cost or fair market value based on appraised value less estimated selling costs. Losses arising from the acquisition of properties are charged against the allowance for loan losses. Other real estate aggregated amounted to \$11,155,992, \$1,317,990 and \$1,749,917 at December 31, 2007, 2006, and 2005, respectively, and is included in other assets. Transfers from loans to other real estate amounted to \$12,106,416 in 2007. Transfers from other real estate to loans amounted to \$477,907.

### Income Taxes

The Company accounts for income taxes on the accrual basis through the use of the liability method. Under the liability method, deferred taxes are recognized for the tax consequences of temporary differences by applying enacted statutory tax rates applicable to future years to differences between the financial statement carrying amounts and the basis of existing assets and liabilities. The effect on deferred taxes of a change in tax rates would be recognized in income in the period that includes the enactment date.

### Treasury Stock

Treasury stock purchases and sales are accounted for using the cost method.

### Earnings Per Share

Basic earnings per share ("EPS") are computed by dividing net income by the weighted average number of shares outstanding during the period. Diluted earnings per share are computed based on the weighted average shares outstanding during the period plus the dilutive effect of outstanding stock options. There are no outstanding options as of December 31, 2007.

The following table represents the earnings per share calculations for the years ended December 31, 2007, 2006, and 2005.

<u>For the Years Ended:</u>	<u>Net Income</u>	<u>Weighted Average Shares</u>	<u>Earnings Per Share</u>
December 31, 2007 .....	\$ 348,624	6,174,473	\$0.06
December 31, 2006 .....	\$14,244,541	6,367,232	\$2.24
December 31, 2005 .....	\$13,656,053	6,428,287	\$2.12

# UNITED SECURITY BANCSHARES, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(CONTINUED)

### New Accounting Standards

In July 2006, the FASB issued Interpretation 48, which requires that only benefits from tax positions that are more-likely-than-not of being sustained upon examination should be recognized in the financial statements. The Company believes all federal and state tax benefits recorded are more-likely-than-not of being sustained upon examination.

In September 2006, the FASB ratified the consensus the Emerging Issues Task Force ("EITF") reached regarding EITF Issue No. 06-4, "Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements" ("Issue 06-4"), which provides accounting guidance for postretirement benefits related to endorsement split-dollar life insurance arrangements, whereby the employer owns and controls the insurance policies. The consensus concludes that an employer should recognize a liability for the postretirement benefit in accordance with Statement of Financial Accounting Standards No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions" ("Statement 106") or Accounting Principles Board Opinion No. 12 ("APB 12"). In addition, the consensus states that an employer should also recognize an asset based on the substance of the arrangement with the employee. Issue 06-4 is effective for fiscal years beginning after December 15, 2007, with early application permitted. The Company is in the process of reviewing the potential impact of Issue 06-4.

In September 2006, the FASB issued SFAS Statement of Financial Accounting Standards No. 157, "Fair Value Measurements" ("Statement 157"), which provides guidance for using fair value to measure assets and liabilities, but does not expand the use of fair value in any circumstance. Statement 157 also requires expanded disclosures about the extent to which a company measures assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on an entity's financial statements. The statement applies whenever other standards require or permit assets and liabilities to be measured at fair value. Statement 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years, with early adoption permitted. The Company is in the process of reviewing the potential impact of this statement.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" ("Statement 159"). Statement 159 allows entities to voluntarily choose, at specified election dates, to measure financial assets and financial liabilities (as well as certain nonfinancial instruments that are similar to financial instruments) at fair value (the "fair value option"). The election is made on an instrument-by-instrument basis and is irrevocable. If the fair value option is elected for an instrument, Statement 159 specifies that all subsequent changes in fair value for that instrument be reported in earnings. Statement 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007, and earlier adoption is permitted. The Company is in the process of reviewing the potential impact of this statement.

In March 2007, the FASB ratified the consensus the EITF reached regarding EITF Issue No. 06-10, "Accounting for Collateral Assignment Split-Dollar Life Insurance Arrangements" ("Issue 06-10"), which provides accounting guidance for postretirement benefits related to collateral assignment split-dollar life insurance arrangements, whereby the employee owns and controls the insurance policies. The consensus concludes that an employer should recognize a liability for the postretirement benefit in accordance with Statement 106 or APB 12, as well as recognize an asset based on the substance of the arrangement with the employee. Issue 06-10 is effective for fiscal years beginning after December 15, 2007, with early application permitted. The Company believes the adoption of this pronouncement will not have a material impact on its financial statements.

In December 2007, the FASB issued SFAS No. 141R, "Business Combinations." This Statement replaces FASB SFAS No. 141. SFAS 141R establishes principles and requirements for how the acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree. SFAS 141R also provides guidance for recognizing and measuring the goodwill acquired in the business combination and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. This Statement applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The Company believes the adoption of this pronouncement will not have a material impact on its financial statements.

**UNITED SECURITY BANCSHARES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(CONTINUED)**

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements—an amendment of ARB No. 51." This Statement amends ARB 51 to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. It clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. In addition to the amendments to ARB 51, this Statement amends FASB Statement No. 128, "Earnings per Share," so that earnings-per-share data will continue to be calculated the same way those data were calculated before this Statement was issued. This Statement is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. The Company believes the adoption of this pronouncement will not have a material impact on its financial statements.

### 3. INVESTMENT SECURITIES

Details of investment securities available-for-sale at December 31, 2007, and 2006 are as follows:

December 31, 2007				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Obligations of states, counties, and political subdivisions	\$ 16,272,675	\$ 292,055	\$ (5,306)	\$ 16,559,424
U.S. treasury securities	119,536	604	0	120,140
Obligations of U.S. government sponsored agencies	5,333,331	48,214	0	5,381,545
Mortgage-backed securities	120,817,763	1,283,569	(373,973)	121,727,359
Equity securities	132,120	142,837	0	274,957
Preferred stock	468,000	0	0	468,000
Total	<u>\$143,143,425</u>	<u>\$1,767,279</u>	<u>\$(379,279)</u>	<u>\$144,531,425</u>

December 31, 2006				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Obligations of states, counties, and political subdivisions	\$ 16,451,250	\$301,405	\$ (20,714)	\$ 16,731,941
U.S. treasury securities	119,720	0	(20)	119,700
Obligations of U.S. government sponsored agencies	5,847,931	4,068	(527)	5,851,472
Mortgage-backed securities	97,294,875	358,863	(1,461,360)	96,192,378
Equity securities	132,120	162,713	0	294,833
Preferred stock	573,000	0	0	573,000
Total	<u>\$120,418,896</u>	<u>\$827,049</u>	<u>\$(1,482,621)</u>	<u>\$119,763,324</u>

The scheduled maturities of investment securities available-for-sale at December 31, 2007, are presented in the following table:

	Amortized Cost	Estimated Fair Value
Maturing within one year	\$ 5,201,267	\$ 5,221,921
Maturing after one to five years	9,306,015	9,411,037
Maturing after five to fifteen years	67,240,678	68,089,531
Maturing after fifteen years	60,795,345	61,065,979
Equity securities and Preferred stock	600,120	742,957
Total	<u>\$143,143,425</u>	<u>\$144,531,425</u>



**UNITED SECURITY BANCSHARES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(CONTINUED)**

For purposes of the maturity table, mortgage-backed securities, which are not due at a single maturity date, have been allocated over maturity groupings based on the weighted-average contractual maturities of underlying collateral. The mortgage-backed securities generally mature earlier than their weighted-average contractual maturities because of principal prepayments.

The following table reflects the Company's investments' gross unrealized losses and market value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2007, and 2006. The Company does not believe any individual unrealized loss represents an other-than-temporary impairment. The Company has the intent and ability to hold these securities until such time as the value recovers or the securities mature.

December 31, 2007				
	Less than 12 Months		12 Months or More	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Obligations of states, counties, and political subdivisions . . .	\$ 289,203	\$ (398)	\$ 494,607	\$ (4,908)
U.S. treasury securities . . . . .	0	0	0	0
Obligations of U.S. government sponsored agencies . . . . .	0	0	0	0
Mortgage-backed securities . . . . .	3,429,610	(9,569)	27,478,987	(364,404)
Total . . . . .	<u>\$3,718,813</u>	<u>\$(9,967)</u>	<u>\$27,973,594</u>	<u>\$(369,312)</u>

December 31, 2006				
	Less than 12 Months		12 Months or More	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Obligations of states, counties, and political subdivisions . . . . .	\$ 765,362	\$ (1,067)	\$ 2,183,443	\$ (19,647)
U.S. treasury securities . . . . .	119,700	(20)	0	0
Obligations of U.S. government sponsored agencies . . . . .	980,628	(527)	0	0
Mortgage-backed securities . . . . .	15,924,936	(88,153)	55,313,472	(1,373,207)
Total . . . . .	<u>\$17,790,626</u>	<u>\$(89,767)</u>	<u>\$57,496,915</u>	<u>\$(1,392,854)</u>

Management evaluates securities for other-than-temporary impairment no less frequently than quarterly, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Company to retain its investments in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

As of December 31, 2007, thirty-seven debt securities have been in a loss position for more than twelve months and eleven debt securities have been in a loss position for less than twelve months. The losses for all securities are considered to be a direct result of rising interest rates and the effect that rising rates has on the value of debt securities and not related to the credit worthiness of the issuers. Further, the Company has the current intent and ability to hold the securities to an expected recovery in market value. Therefore, the Company has not recognized any other-than-temporary impairments.

Investment securities available-for-sale with a carrying value of \$95.2 million and \$85.8 million December 31, 2007, and 2006, respectively, were pledged to secure public deposits and for other purposes.

**UNITED SECURITY BANCSHARES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(CONTINUED)**

Net losses on securities available-for-sale were \$107,156, \$268, and \$37,232 in 2007, 2006, and 2005, respectively. Net losses from the sale of securities were \$2,156 in 2007. In addition, a \$105,000 impairment loss was recorded related to the investment in preferred stock. The following chart represents the gross gains and losses for the years 2005 through 2007.

	Gross Gains	Gross Losses	Net Gains (Losses)
2007 .....	\$ 3,349	\$110,505	\$(107,156)
2006 .....	0	268	(268)
2005 .....	106,449	143,681	(37,232)

#### 4. LOANS AND ALLOWANCE FOR LOAN LOSS

At December 31, 2007, and 2006, the composition of the loan portfolio was as follows:

	2007	2006
Commercial, financial, and agricultural .....	\$ 40,647,861	\$ 34,933,133
Real estate mortgage .....	319,664,879	311,988,879
Consumer installment .....	82,482,801	109,643,169
Less:		
Unearned interest, commissions, and fees .....	6,672,457	7,326,580
Total loans net of unearned interest, commissions, and fees .....	436,123,084	449,238,601
Allowance for loan losses .....	8,535,230	7,664,432
Total .....	<u>\$427,587,854</u>	<u>\$441,574,169</u>

The Company grants commercial, real estate, and installment loans to customers primarily in Clarke, Choctaw, Bibb, Shelby, Tuscaloosa, and surrounding counties in Alabama, and Southeast Mississippi. Although the Company has a diversified loan portfolio, 73.3% of the portfolio is concentrated in loans secured by real estate.

In the ordinary course of business, the Bank makes loans to certain officers and directors of the Company and the Bank, including companies with which they are associated. These loans are made on the same terms as those prevailing for comparable transactions with others. Such loans do not represent more than normal risk of collectibility nor do they present other unfavorable features. The amounts of such related party loans and commitments at December 31, 2007, and 2006, were \$1,360,729 and \$1,096,183, respectively. During the year ended December 31, 2007, new loans to these parties totaled \$1,995,450 and repayments were \$1,730,904.

A summary of the transactions in the allowance for loan losses follows:

	2007	2006	2005
Balance at beginning of year .....	\$ 7,664,432	\$ 7,694,011	\$ 7,060,754
Provision for loan losses .....	21,152,274	3,725,974	3,853,052
Loans charged-off .....	(21,634,211)	(4,736,214)	(4,015,005)
Recoveries of loans previously charged-off .....	1,352,735	980,661	795,210
Balance at end of year .....	<u>\$ 8,535,230</u>	<u>\$ 7,664,432</u>	<u>\$ 7,694,011</u>

Impaired loans totaled \$15,720,232, \$7,318,047, and \$5,662,303 as of December 31, 2007, 2006, and 2005, respectively. There was approximately \$1,624,648, \$847,676 and \$816,283 in the allowance for loan losses specifically allocated to these impaired loans at December 31, 2007, 2006, and 2005, respectively. The average recorded investment in impaired loans for 2007, 2006, and 2005 was approximately \$8,809,856, \$6,858,270, and \$2,509,750, respectively.

**UNITED SECURITY BANCSHARES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(CONTINUED)**

Loans on which the accrual of interest has been discontinued amounted to \$5,252,597, \$7,318,047, and \$5,662,303 at December 31, 2007, 2006, and 2005, respectively. If interest on those loans had been accrued, such income would have approximated \$501,003, \$874,319, and \$701,191 for 2007, 2006, and 2005, respectively. Interest income actually recorded on those loans amounted to \$169,941, \$186,344, and \$49,361 for 2007, 2006, and 2005, respectively. Accruing loans past due 90 days or more amounted to \$5,239,547, \$2,033,326, and \$1,203,027 for 2007, 2006, and 2005, respectively.

**5. PREMISES AND EQUIPMENT**

Premises and equipment and their depreciable lives are summarized as follows:

	2007	2006
Land .....	\$ 2,470,686	\$ 2,470,686
Premises (40 years) .....	21,001,477	20,930,811
Furniture, fixtures, and equipment (3-7 years) .....	11,228,685	11,056,254
Total .....	34,700,848	34,457,751
Less accumulated depreciation .....	16,568,935	15,593,276
Total .....	<u>\$18,131,913</u>	<u>\$18,864,475</u>

Depreciation expense of \$953,871, \$957,428, and \$931,272 was recorded in 2007, 2006, and 2005, respectively, on premises and equipment.

**6. GOODWILL AND INTANGIBLE ASSETS**

The Company has goodwill assets of \$4,097,773 and \$4,097,773 included in other assets as of December 31, 2007, and 2006. Management conducted its annual impairment testing June 30, 2007, and determined that there was no impairment.

**7. INVESTMENT IN LIMITED PARTNERSHIPS**

The Company has limited partnership investments in affordable housing projects, for which it provides funding as a limited partner and receives tax credits related to its investments in the projects based on its partnership share. The Company has invested in limited partnerships of affordable housing projects, both as direct investments and investments in funds that invest solely in affordable housing projects. The Company has determined that these structures meet the definition of a variable interest entity. The Company has determined that it needs to consolidate one of the funds in which it is the sole limited partner. The Company also has determined that this fund is required to consolidate one of the affordable housing projects the fund invests in. The resulting financial impact to the consolidation of the Company is a net increase to total assets of approximately \$3.2 million. This includes \$8.1 million in premises and equipment less a loan totaling \$5.5 million. This loan payable by the partnership to the Company was eliminated as a result of this consolidation. Unconsolidated investments in these partnerships are accounted for under the cost method as allowed under EITF 94-1. The Company amortizes the excess of carrying value of the investment over its estimated residual value during the period in which tax credits are allocated to the investors. The Company's maximum exposure to future loss related to these limited partnerships is limited to the \$2.0 million recorded investment.

The assets and liabilities of these partnerships consist primarily of apartment complexes and related mortgages. The Bank's carrying value approximates cost or its underlying equity in the net assets of the partnerships. Market quotations are not available for any of the aforementioned partnerships.

The Bank had no remaining cash commitments to these partnerships at December 31, 2007.

**UNITED SECURITY BANCSHARES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(CONTINUED)**

**8. DEPOSITS**

At December 31, 2007, the scheduled maturities of the Bank's time deposits are as follows:

2008 .....	\$219,869,658
2009 .....	16,179,696
2010 .....	28,345,889
2011 .....	14,398,387
2012 and thereafter .....	<u>11,747,534</u>
Total .....	<u>\$290,541,164</u>

At December 31, 2007, and 2006, the Company had brokered certificates of deposit totaling \$20,870,721 and \$24,795,081, respectively.

**9. SHORT-TERM BORROWINGS**

Short-term borrowings consist of federal funds purchased, thirty-day Federal Home Loan Bank ("FHLB") advances, treasury tax and loan deposits and securities sold under repurchase agreements. Federal funds purchased generally mature within one to four days. None were outstanding at year-end 2007 or 2006. Treasury tax and loan deposits totaled \$930,257 and \$1,463,338 at year-end 2007 and 2006, respectively. These deposits are withdrawable on demand. A \$10.0 million FHLB advance, with a maturity date of January 14, 2008, was outstanding at December 31, 2007.

Securities sold under repurchase agreements, which are secured borrowings, generally are reflected at the amount of cash received in connection with the transaction. The Company may be required to provide additional collateral based on the fair value of the underlying securities. The Company monitors the fair value of the underlying securities on a daily basis. Securities sold under repurchase agreements at December 31, 2007, and 2006, were \$281,692 and \$293,650, respectively.

At December 31, 2007, the Bank has \$25.0 million in available federal fund lines from correspondent banks.

**10. LONG-TERM DEBT**

The Company uses FHLB advances as an alternative to funding sources with similar maturities such as certificates of deposit or other deposit programs. These advances generally offer more attractive rates when compared to other mid-term financing options. They are also flexible, allowing the Company to quickly obtain the necessary maturities and rates that best suit its overall asset/liability strategy. At December 31, 2007, and 2006, investment securities and mortgage loans amounting to \$85,401,505 and \$89,099,490, respectively, were pledged to secure these borrowings.

The following summarizes information concerning FHLB advances and other borrowings:

	2007	2006	2005
Balance at year-end .....	\$77,517,544	\$87,552,632	\$89,587,719
Average balance during the year .....	77,147,801	84,010,382	89,602,271
Maximum month-end balance during the year .....	87,543,860	89,578,947	89,620,980
Average rate paid during the year .....	4.86%	4.93%	4.01%
Weighted average remaining maturity .....	2.84 years	1.47 years	2.01 years

Interest rates on FHLB advances ranged from 4.18% to 6.40% and from 5.07% to 6.40% at December 31, 2007, and 2006, respectively.

**UNITED SECURITY BANCSHARES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(CONTINUED)**

Scheduled maturities of FHLB advances are approximately \$7.5 million for 2008, \$15.0 million for 2009, and \$35.0 million for 2010. In 2011 there are no scheduled maturities. In 2012 there are \$20.0 million in scheduled maturities. In 2013 and thereafter, there are no scheduled maturities.

At December 31, 2007, the Bank has \$110.1 million in available credit from the FHLB.

## 11. INCOME TAXES

The consolidated provisions for and (benefits from) income taxes for the years ended December 31 were as follows:

	<u>2007</u>	<u>2006</u>	<u>2005</u>
Federal			
Current .....	\$ (540,794)	\$6,297,459	\$5,649,326
Deferred .....	(441,392)	(57,737)	(806,929)
	(982,186)	6,239,722	4,842,397
State			
Current .....	(151,451)	867,051	927,267
Deferred .....	(86,192)	(11,492)	(190,632)
	(237,643)	855,559	736,635
Total .....	<u>\$(1,219,829)</u>	<u>\$7,095,281</u>	<u>\$5,579,032</u>

The consolidated tax provision differed from the amount computed by applying the federal statutory income tax rate of 35.0% to pretax earnings for the following reasons:

	<u>2007</u>	<u>2006</u>	<u>2005</u>
Income tax expense at federal statutory rate .....	\$ (304,671)	\$7,468,938	\$6,631,007
Increase (decrease) resulting from:			
Tax-exempt interest .....	(354,936)	(372,023)	(491,023)
State income tax expense, net of federal income tax benefit .....	(195,346)	571,609	491,828
Low income housing tax credits .....	(280,499)	(328,507)	(582,442)
Other .....	(84,377)	(244,736)	(470,338)
Total .....	<u>\$(1,219,829)</u>	<u>\$7,095,281</u>	<u>\$5,579,032</u>

**UNITED SECURITY BANCSHARES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(CONTINUED)**

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 2007, and 2006, are presented below:

	<u>2007</u>	<u>2006</u>
Deferred tax assets:		
Allowance for loan losses .....	\$3,243,387	\$2,912,484
Accrued vacation .....	51,859	51,946
Deferred compensation .....	1,051,991	855,612
Deferred commission and fees .....	328,885	394,573
Unrealized loss on securities available-for-sale .....	0	245,832
Other .....	335,231	178,862
Total gross deferred tax assets .....	<u>5,011,353</u>	<u>4,639,309</u>
Deferred tax liabilities:		
Premises and equipment .....	411,510	467,500
Limited partnerships .....	154,935	57,155
Unrealized gain on cash flow hedge .....	4,654	80,894
Goodwill amortization .....	672,850	560,708
Gain / loss on sale of investments .....	22,032	19,411
Unrealized gain on securities available-for-sale .....	523,180	0
Other .....	169,129	154,496
Total gross deferred tax liabilities .....	<u>1,958,290</u>	<u>1,340,164</u>
Net deferred tax asset .....	<u><u>\$3,053,063</u></u>	<u><u>\$3,299,145</u></u>

Management has determined that a valuation allowance should not be recorded on its deferred tax assets as of December 31, 2007 and 2006, based on its projection of future taxable income and other relevant considerations.

## 12. EMPLOYEE BENEFIT PLANS

The Company sponsors an employee stock ownership plan, the United Security Bancshares, Inc. Employee Stock Ownership Plan (With 401(k) Provisions). This plan covers substantially all employees and allows employees to contribute up to 15% of their compensation on a before-tax basis. The Company makes safe harbor contributions on behalf of all participants equal to the sum of 100% of an employee's elective deferrals that do not exceed 3% of compensation, plus 50% of the employee's elective deferrals that exceed 3% but that do not exceed 5% of compensation. The Company also made a discretionary contribution in the amount of 2% of an employee's compensation in 2006. Employees have the option to allocate some or all of their contributions towards the purchase of Company stock. The Company made matching contributions totaling \$438,069 and \$448,041 in 2007 and 2006, respectively. The plan held 267,981 and 299,999 shares at December 31, 2007, and 2006, respectively. These shares are included in the earnings per share calculations because they are all allocated to the participants.

## 13. LONG-TERM INCENTIVE COMPENSATION PLAN

The Bank has entered into supplemental compensation benefits agreements with the directors and certain executive officers. The measurement of the liability under these agreements includes estimates involving life expectancy, length of time before retirement and the expected returns on the Bank-owned life insurance policies used to fund those agreements. Should these estimates prove materially wrong, the cost of these agreements could change accordingly. The related deferred compensation obligation to these directors and executive officers totaled \$2,333,240 and \$1,878,854 as of December 31, 2007, and 2006, respectively. These amounts are included in other liabilities.

**UNITED SECURITY BANCSHARES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(CONTINUED)**

Under the United Security Bancshares, Inc. Non-Employee Directors' Deferred Compensation Plan, participants may elect to defer all or a portion of their directors' fees and to receive the adjusted value of the deferred amounts in cash and/or to receive the adjusted value of the deferred amounts as if the deferred amounts were invested in shares of USB stock. In the event a participant elects to defer amounts as if the deferred amounts were invested in USB stock, the participant does not have any rights as a shareholder of the common stock deferred under the plan until the termination date on which the participant's account is distributed in accordance with terms of the plan. Neither the Company nor the Bank makes any contribution to participants' accounts under the plan.

While not required by the plan, the Company established a grantor trust (Rabbi Trust) as an instrument to fund the stock portion of the plan. At December 31, 2007, and 2006, the grantor trust held 9,483 and 6,875 shares of the Company's common stock. These shares have been classified in equity as treasury stock. The related deferred compensation obligation included in other liabilities was \$256,350 and \$193,950 as of December 31, 2007, and 2006, respectively.

#### **14. SHAREHOLDERS' EQUITY**

Dividends paid by the Company are primarily from dividends received from the Bank. However, certain restrictions exist regarding the ability of the Bank to transfer funds to the Company in the form of cash dividends, loans, or advances. Due to reduced earnings as a result of losses suffered at ALC in 2007, and dividends paid to fund the stock repurchase program over the last several years, approval from the State Banking Department was required to pay dividends in 2008. This approval was granted January 28, 2008.

The Company is subject to various regulatory capital requirements that prescribe quantitative measures of the Company's assets, liabilities, and certain off-balance sheet items. The Company's regulators also have imposed qualitative guidelines for capital amounts and classifications such as risk weightings, capital components, and other details. The quantitative measures to ensure capital adequacy require that the Company maintain amounts and ratios, as set forth in the schedule below, of total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined in the regulations) and of Tier I capital to average total assets (as defined in the regulations). Failure to meet minimum capital requirements can initiate certain actions by regulators that, if undertaken, could have a direct material effect on the Company's financial statements. Management believes, as of December 31, 2007, and 2006, that the Company met all capital adequacy requirements imposed by its regulators.

As of December 31, 2007, and 2006, the most recent notification from the Federal Deposit Insurance Corporation categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier I risk-based, and Tier I leverage ratios as set forth in the table. There have been no conditions or events since that notification that management believes have changed the institution's category.

**UNITED SECURITY BANCSHARES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(CONTINUED)**

Actual capital amounts as well as required and well capitalized total risk-based, Tier I risk-based, and Tier I leverage ratios as of December 31, 2007, and 2006, for the Company and the Bank are as follows:

	2007					
	Actual		Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(Dollars in Thousands)					
Total Capital (to Risk Weighted Assets):						
United Security Bancshares, Inc. ....	\$81,374	17.67%	\$36,839	8.00%	N/A	N/A
First United Security Bank .....	81,286	17.66%	36,826	8.00%	\$46,033	10.00%
Tier I Capital (to Risk Weighted Assets):						
United Security Bancshares, Inc. ....	75,520	16.40%	18,419	4.00%	N/A	N/A
First United Security Bank .....	75,498	16.40%	18,413	4.00%	27,620	6.00%
Tier I Leverage (to Average Assets):						
United Security Bancshares, Inc. ....	75,520	11.43%	19,824	3.00%	N/A	N/A
First United Security Bank .....	75,498	11.43%	19,813	3.00%	33,022	5.00%
	2006					
	Actual		Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(Dollars in Thousands)					
Total Capital (to Risk Weighted Assets):						
United Security Bancshares, Inc. ....	\$94,112	20.67%	\$36,432	8.00%	N/A	N/A
First United Security Bank .....	93,650	20.57%	36,416	8.00%	\$45,521	10.00%
Tier I Capital (to Risk Weighted Assets):						
United Security Bancshares, Inc. ....	88,322	19.39%	18,216	4.00%	N/A	N/A
First United Security Bank .....	87,936	19.32%	18,208	4.00%	27,312	6.00%
Tier I Leverage (to Average Assets):						
United Security Bancshares, Inc. ....	88,322	13.60%	19,458	3.00%	N/A	N/A
First United Security Bank .....	87,936	13.55%	19,469	3.00%	32,449	5.00%



**UNITED SECURITY BANCSHARES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(CONTINUED)**

**15. SEGMENT REPORTING**

Under SFAS No. 131, *Disclosure about Segments of an Enterprise and Related Information*, certain information is disclosed for the three reportable operating segments of the Company. The reportable segments were determined using the internal management reporting system. They are composed of the Company's and Bank's significant subsidiaries. The accounting policies for each segment are the same as those described in Note 2, Summary of Significant Accounting Policies. The segment results include certain overhead allocations and intercompany transactions that were recorded at current market prices. All intercompany transactions have been eliminated to determine the consolidated balances. The results for the three reportable segments of the Company are included in the following table:

	2007				
	FUSB	ALC	All Other (In Thousands)	Eliminations	Consolidated
Total interest income .....	\$ 44,875	\$ 23,510	\$ 86	\$ (8,488)	\$ 59,983
Total interest expense .....	19,511	8,377	64	(8,488)	19,464
Net interest income .....	25,364	15,133	22	0	40,519
Provision for loan losses .....	982	20,170	0	0	21,152
Net interest income (expense) after provision .....	24,382	(5,037)	22	0	19,367
Total non-interest income .....	4,468	530	1,645	(1,077)	5,566
Total non-interest expense .....	16,083	8,997	1,236	(512)	25,804
Income (loss) before income taxes .....	12,767	(13,504)	431	(565)	(871)
Provision for (benefit from) income taxes .....	3,924	(5,166)	22	0	(1,220)
Net income (loss) .....	<u>\$ 8,843</u>	<u>\$ (8,338)</u>	<u>\$ 409</u>	<u>\$ (565)</u>	<u>\$ 349</u>
Other significant items:					
Total assets .....	\$664,884	\$116,251	\$94,011	\$(215,250)	\$659,896
Total investment securities .....	144,146	0	385	0	144,531
Total loans, net .....	439,730	108,015	0	(120,157)	427,588
Goodwill .....	3,111	0	986	0	4,097
Investment in subsidiaries .....	1,751	63	79,703	(81,439)	78
Fixed asset addition .....	237	218	21	0	476
Depreciation and amortization expense ...	731	187	35	0	953
Total interest income from external customers .....	36,444	23,510	28	0	59,983
Total interest income from affiliates .....	8,431	0	57	(8,380)	0

**UNITED SECURITY BANCSHARES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(CONTINUED)**

	2006				
	FUSB	ALC	All Other (In Thousands)	Eliminations	Consolidated
Total interest income	\$ 42,282	\$ 25,463	\$ 88	\$ (8,614)	\$ 59,219
Total interest expense	16,028	8,568	10	(8,614)	15,992
Net interest income	26,254	16,895	78	0	43,227
Provision for loan losses	903	2,823	0	0	3,726
Net interest income after provision	25,351	14,072	78	0	39,501
Total non-interest income	4,509	538	15,718	(15,144)	5,621
Total non-interest expense	15,609	7,574	1,108	(509)	23,782
Income before income taxes	14,251	7,036	14,688	(14,635)	21,340
Provision for income taxes	4,539	2,537	19	0	7,095
Net income (loss)	\$ 9,712	\$ 4,499	\$ 14,669	\$ (14,635)	\$ 14,245
Other significant items:					
Total assets	\$633,984	\$139,460	\$105,131	\$(232,279)	\$646,296
Total investment securities	119,136	0	627	0	119,763
Total loans, net	436,277	134,040	0	(128,743)	441,574
Goodwill	3,111	0	987	0	4,098
Investment in subsidiaries	1,860	63	90,895	(92,740)	78
Fixed asset addition	544	101	0	0	645
Depreciation and amortization expense	754	169	34	0	957
Total interest income from external customers	33,715	25,463	41	0	59,219
Total interest income from affiliates	8,514	0	47	(8,561)	0
2005					
	FUSB	ALC	All Other (In Thousands)	Eliminations	Consolidated
Total interest income	\$ 37,590	\$ 23,188	\$ 89	\$ (8,188)	\$ 52,679
Total interest expense	11,853	8,137	8	(8,188)	11,810
Net interest income	25,737	15,051	81	0	40,869
Provision for loan losses	675	3,178	0	0	3,853
Net interest income after provision	25,062	11,873	81	0	37,016
Total non-interest income	4,256	558	14,922	(14,458)	5,278
Total non-interest expense	15,463	7,171	994	(569)	23,059
Income before income taxes	13,855	5,260	14,009	(13,889)	19,235
Provision for income taxes	3,621	1,940	18	0	5,579
Net income (loss)	\$ 10,234	\$ 3,320	\$ 13,991	\$ (13,889)	\$ 13,656
Other significant items:					
Total assets	\$610,518	\$135,469	\$100,659	\$(225,163)	\$621,483
Total investment securities	110,109	0	656	0	110,765
Total loans, net	431,384	129,404	0	(129,261)	431,527
Goodwill	3,111	0	987	0	4,098
Investment in subsidiaries	2,187	63	85,334	(87,506)	78
Fixed asset addition	572	99	0	0	671
Depreciation and amortization expense	738	158	35	0	931
Total interest income from external customers	29,452	23,189	38	0	52,679
Total interest income from affiliates	8,084	0	51	(8,135)	0

**UNITED SECURITY BANCSHARES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(CONTINUED)**

**16. OTHER OPERATING EXPENSES**

Other operating expenses for the years 2007, 2006, and 2005 consist of the following:

	2007	2006	2005
Legal, accounting and other professional fees .....	\$2,303,623	\$ 860,534	\$ 802,430
Postage, stationary, and supplies .....	876,364	841,935	801,329
Telephone/data communication .....	647,467	627,378	429,341
Write-down other real estate .....	798,526	60,000	68,000
Other .....	4,330,394	3,907,121	3,922,021
Total .....	<u>\$8,956,374</u>	<u>\$6,296,968</u>	<u>\$6,023,121</u>

**17. OPERATING LEASES**

The Company leases equipment and office space under noncancellable operating leases and also month-to-month rental agreements.

The following is a schedule, by years, of future minimum rental payments required under operating leases having initial or remaining noncancellable terms in excess of one year as of December 31, 2007:

Year ending December 31,	
2008 .....	\$368,094
2009 .....	244,944
2010 .....	164,106
2011 .....	45,171

Total rental expense under all operating leases was \$566,204, \$543,495, and \$521,098 in 2007, 2006, and 2005, respectively.

**18. GUARANTEES, COMMITMENTS, AND CONTINGENCIES**

The Bank's exposure to credit loss in the event of nonperformance by the other party for commitments to make loans and standby letters of credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making these commitments as it does for on-balance sheet instruments. For interest rate swap transactions, and commitments to purchase or sell securities for forward delivery, the contract or notional amounts do not represent exposure to credit loss. The Bank controls the credit risk of these derivative instruments through credit approvals, limits, and monitoring procedures. Certain derivative contracts have credit risk for the carrying value plus the amount to replace such contracts in the event of counter party default. All of the Bank's financial instruments are held for risk management and not for trading purposes. During the years ended December 31, 2007, 2006, and 2005, there were no credit losses associated with derivative contracts.

In the normal course of business there are outstanding commitments and contingent liabilities, such as commitments to extend credit, letters of credit, and others, which are not included in the consolidated financial statements. The financial instruments involve, to varying degrees, elements of credit and interest rate risk in excess of amounts recognized in the financial statements. A summary of these commitments and contingent liabilities is presented below:

	December 31,	
	2007	2006
	(In Thousands)	
Standby Letters of Credit .....	\$ 620	\$ 1,869
Commitments to Extend Credit .....	\$47,275	\$54,777

## UNITED SECURITY BANCSHARES, INC. AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(CONTINUED)

Standby letters of credit are contingent commitments issued by the Company generally to guarantee the performance of a customer to a third party. The Company has recourse against the customer for any amount it is required to pay to a third party under a standby letter of credit. Revenues are recognized over the lives of the standby letters of credit. The potential amount of future payments the Company could be required to make under its standby letters of credit at December 31, 2007, is \$620,000 and represents the Company's total credit risk.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the counter party. Collateral held varies but may include accounts receivable, inventory, property, plant, and equipment, and income-producing commercial properties.

Commitments to purchase securities for delayed delivery require the Bank to purchase a specified security at a specified price for delivery on a specified date. Similarly, commitments to sell securities for delayed delivery require the Bank to sell a specified security at a specified price for delivery on a specified date. Market risk arises from potential movements in security values and interest rates between the commitment and delivery dates. At December 31, 2007, there were no outstanding commitments to purchase and sell securities for delayed delivery.

In January 2006, the Company sold its credit card portfolio in the amount of approximately \$575,000. To facilitate this sale, the Company was required to guarantee certain accounts. The current balance of these accounts at December 31, 2007, was \$19,444. The maximum exposure under this guaranty, which includes the credit limit on these accounts, amounts to \$22,500.

#### Litigation

On September 27, 2007, Malcomb Graves Automotive, LLC, Malcomb Graves, and Tina Graves (collectively, "Graves") filed a lawsuit in the Circuit Court of Shelby County, Alabama against the Company, the Bank, ALC and their respective directors and officers seeking an unspecified amount of compensatory and punitive damages. The complaint alleges that the defendants committed fraud in allegedly misrepresenting to Graves the amounts Graves owed on certain loans and failing to credit Graves properly for certain loans. The defendants deny the allegations. The defendants are in the process of responding to the complaint, and no discovery has been exchanged between the parties. The defendants have moved to compel arbitration in this matter, but the trial court has not ruled on this motion to date. For this reason, it is too early for management to assess the likelihood of a resolution of this matter or whether this matter will have a material adverse effect on the Company's consolidated financial condition or results of operations.

The Company and its subsidiaries are parties to other litigation arising in the normal course of business. In the opinion of management, based on review and consultation with legal counsel, the ultimate disposition of such litigation is not expected to have a material adverse effect on the consolidated financial condition or results of operations.

## 19. DERIVATIVE FINANCIAL INSTRUMENTS

The Bank is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers and in connection with its interest rate risk management, investing, and trading activities. These financial instruments include commitments to extend credit and standby letters of credit.

The Bank's principal objective in holding derivative financial instruments is asset-liability management. The operations of the Bank are subject to a risk of interest rate fluctuations to the extent that there is a difference between the amount of the Bank's interest-earning assets and the amount of interest-bearing liabilities that mature or reprice in specified periods. The principal objective of the Bank's asset-liability management activities is to provide maximum levels of net interest income while maintaining acceptable levels of interest rate and liquidity risk and facilitating the funding needs of the

## UNITED SECURITY BANCSHARES, INC. AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(CONTINUED)

Bank. To achieve that objective, the Bank uses a combination of derivative financial instruments, including interest rate swaps. Note 2 to the Consolidated Financial Statements includes a summary of how derivative instruments used for interest rate risk management are accounted for in the financial statements.

Interest rate swaps acquired for other than trading purposes are used to help reduce the risk of interest rate movements for specific categories of assets and liabilities. At December 31, 2007, no interest rate swaps were outstanding.

Two cash-flow hedges with a notional amount of \$18.0 million were terminated during the first quarter of 2005 that resulted in a \$592,000 gain, which is reported in other comprehensive income. This gain will be reclassified from other comprehensive income to income over the original remaining term of the swaps. During 2007 and 2006, \$203,306 and \$215,018, respectively, were reclassified into income. The remaining balance not reclassified into income was \$12,411 at December 31, 2007. This remaining balance will be reclassified into income in 2008.

Two interest rate swaps with a total notional amount of \$10.0 million were used to convert fixed-rate brokered certificates of deposit to floating-rate. On January 1, 2006, the Company began accounting for these interest rate swaps under hedge accounting. Net cash flows from these swaps increased interest expense on certificates of deposit by \$108,972 for the year ended December 31, 2007, and \$143,524 for the year ended December 31, 2006. Both swaps were terminated in the third quarter of 2007, resulting in a change to other non-interest expense of \$72,564.

All of the Bank's derivative financial instruments were over-the-counter instruments and were not exchange traded. Market values are obtained from the counter parties to each instrument. The Bank only uses other commercial banks as a counter party to their derivative activity. The Bank performs stress tests and other models to assess risk exposure.

## 20. FAIR VALUE OF FINANCIAL INSTRUMENTS

SFAS No. 107, *Disclosures About Fair Value of Financial Instruments*, requires disclosure of fair value information about financial instruments, whether or not recognized on the face of the statement of condition, for which it is practicable to estimate that value. The assumptions used in the estimation of the fair value of the Company's financial instruments are detailed below. Where quoted prices are not available, fair values are based on estimates using discounted cash flows and other valuation techniques. The use of discounted cash flows can be significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. The following disclosures should not be considered a surrogate of the liquidation value of the Company, but rather represent a good-faith estimate of the increase or decrease in value of financial instruments held by the Company since purchase, origination, or issuance.

The following methods and assumptions were used by the Company in estimating the fair value of its financial instruments:

**Cash, due from banks, and federal funds sold:** The carrying amount of cash, due from banks, and federal funds sold approximates fair value.

**Federal Home Loan Bank:** The carrying amount of Federal Home Loan Bank stock approximates fair value.

**Securities:** Fair values of securities are based on available quoted market prices. The carrying amount of equity securities with no readily determined fair value approximates fair value.

**Accrued interest:** The carrying amount of accrued interest approximates their fair value.

**Loans, net:** For variable-rate loans, fair values are based on carrying values. Fixed-rate commercial loans, other installment loans, and certain real estate mortgage loans were valued using discounted cash flows. The discount rate used to determine the present value of these loans was based on interest rates currently being charged by the Bank on comparable loans as to credit risk and term.

**Derivative instruments:** Fair values of the Company's derivative instruments are based on values obtained from counter parties, or other quotations received from third parties. The Company's loan commitments are negotiated at current market rates and are relatively short-term in nature. As a matter of policy, the

**UNITED SECURITY BANCSHARES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(CONTINUED)**

Company generally makes commitments for fixed-rate loans for relatively short periods of time. Because of this policy and the absence of any known credit exposure, the estimated value of the Company's loan commitments is nominal.

**Demand and savings deposits:** The fair values of demand deposits are equal to the carrying value of such deposits. Demand deposits include non-interest bearing demand deposits, savings accounts, NOW accounts, and money market demand accounts.

**Time deposits:** The fair value of relatively short-term time deposits is equal to their carrying values. Discounted cash flows have been used to value long-term time deposits. The discount rate used is based on interest rates currently being offered by the Bank on comparable deposits as to amount and term.

**Short-term borrowings:** These borrowings may consist of federal funds purchased, securities sold under agreements to repurchase, floating rate borrowings from the FHLB and the U.S. Treasury Tax and Loan account. Due to the short-term nature of these borrowings, fair values approximate carrying values.

**Long-term debt:** The fair value of this debt is estimated using discounted cash flows based on the Company's current incremental borrowing rate for similar types of borrowing arrangements as of December 31, 2007, and 2006:

**Off-balance sheet instruments:** The carrying amount of commitments to extend credit and standby letters of credit approximates fair value. The carrying amount of the off-balance sheet financial instruments is based on fees currently charged to enter into such agreements.

	2007		2006	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
	(In Thousands)			
<b>Assets:</b>				
Cash and cash equivalents	\$ 20,674	\$ 20,674	\$ 28,460	\$ 28,460
Investment securities available-for-sale	144,531	144,531	119,763	119,763
Federal funds sold	0	0	25	25
Federal Home Loan Bank stock	5,096	5,096	5,180	5,180
Accrued interest receivable	6,141	6,141	6,096	6,096
Loans, net of unearned	427,588	429,048	441,574	442,031
Derivative instruments	0	0	6	6
<b>Liabilities:</b>				
Deposits	478,554	481,192	450,062	448,811
Short-term borrowings	11,212	11,212	1,757	1,757
Long-term debt	77,518	78,866	87,553	87,554
Accrued interest payable	3,935	3,935	3,170	3,170

**UNITED SECURITY BANCSHARES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(CONTINUED)**

**21. UNITED SECURITY BANCSHARES, INC. (PARENT COMPANY ONLY) FINANCIAL INFORMATION**

**Statements of Condition**

	Year-ended December 31,	
	2007	2006
<b>ASSETS:</b>		
Cash on deposit .....	\$ 77,406	\$ 177,830
Investment in subsidiaries .....	78,501,482	90,146,745
Investment securities available-for-sale .....	265,011	507,127
Other assets .....	993,527	993,184
<b>TOTAL ASSETS .....</b>	<b>\$79,837,426</b>	<b>\$91,824,886</b>
<b>LIABILITIES:</b>		
Other liabilities .....	\$ 268,819	\$ 229,337
<b>SHAREHOLDERS' EQUITY .....</b>	<b>79,568,607</b>	<b>91,595,549</b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY .....</b>	<b>\$79,837,426</b>	<b>\$91,824,886</b>

**Statements of Income**

	Year-ended December 31,		
	2007	2006	2005
<b>INCOME</b>			
Dividend income, First United Security Bank .....	\$ 13,129,973	\$ 9,171,709	\$ 6,110,660
Interest income .....	10,594	18,910	22,282
Investment securities loss, net .....	(2,662)	0	0
Total income .....	13,137,905	9,190,619	6,132,942
<b>EXPENSE .....</b>	<b>367,362</b>	<b>353,102</b>	<b>310,270</b>
<b>INCOME BEFORE EQUITY IN (DISTRIBUTIONS IN EXCESS OF) UNDISTRIBUTED INCOME OF SUBSIDIARIES .....</b>	<b>12,770,543</b>	<b>8,837,517</b>	<b>5,822,672</b>
<b>EQUITY IN (DISTRIBUTIONS IN EXCESS OF) UNDISTRIBUTED INCOME OF SUBSIDIARIES .....</b>	<b>(12,421,919)</b>	<b>5,407,024</b>	<b>7,833,381</b>
<b>NET INCOME .....</b>	<b>\$ 348,624</b>	<b>\$14,244,541</b>	<b>\$13,656,053</b>

**UNITED SECURITY BANCSHARES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(CONTINUED)**

**Statements of Cash Flows**

	Year-ended December 31,		
	2007	2006	2005
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net income	\$ 348,624	\$ 14,244,541	\$13,656,053
Adjustments to reconcile net income to net cash provided by operating activities:			
Equity in (distributions in excess of) undistributed income of subsidiaries	12,421,919	(5,407,024)	(7,833,381)
Loss on sale of securities, net	2,662	0	0
(Increase) decrease in other assets	(344)	111	352
Increase in other liabilities	47,287	49,864	33,712
Net cash provided by operating activities	12,820,148	8,887,492	5,856,736
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Capital contribution to subsidiary	(66,000)	(65,000)	(75,000)
Proceeds from sales of investment securities available-for-sale	214,594	0	0
Proceeds from maturities and prepayments of investment securities available-for-sale	4,052	63,190	132,158
Net cash provided by (used in) investing activities	152,646	(1,810)	57,158
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Cash dividends paid	(7,337,794)	(6,821,709)	(6,110,660)
Purchase of treasury stock	(5,735,424)	(3,200,349)	0
Net cash used in financing activities	(13,073,218)	(10,022,058)	(6,110,660)
DECREASE IN CASH	(100,424)	(1,136,376)	(196,766)
CASH AT BEGINNING OF YEAR	177,830	1,314,206	1,510,972
CASH AT END OF YEAR	\$ 77,406	\$ 177,830	\$ 1,314,206

**22. QUARTERLY DATA (UNAUDITED)**

	Year-ended December 31,							
	2007				2006			
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
Interest income	\$14,557	\$15,083	\$15,209	\$15,134	\$15,493	\$14,973	\$14,588	\$14,165
Interest expense	4,887	5,099	4,843	4,630	4,472	4,222	3,868	3,430
Net interest income	9,670	9,984	10,361	10,504	11,021	10,751	10,720	10,735
Provision for loan losses	3,462	6,786	9,863	1,041	1,173	763	975	815
Net interest income, after provision for loan losses	6,208	3,198	493	9,463	9,849	9,988	9,745	9,920
Non-interest:								
Income	1,441	1,531	1,352	1,242	1,405	1,548	1,384	1,284
Expense	6,359	7,288	5,989	6,168	5,777	6,322	5,938	5,745
Income (loss) before income taxes	1,290	(2,559)	(4,139)	4,537	5,476	5,214	5,191	5,459
(Benefits from) provision for income taxes	(615)	(692)	(1,408)	1,495	1,842	1,759	1,715	1,779
Net income (loss) after taxes	\$ 1,905	\$ (1,867)	\$ (2,731)	\$ 3,042	\$ 3,634	\$ 3,455	\$ 3,476	\$ 3,680
Earnings (losses) per common share:								
Basic and diluted earnings (losses)	\$ 0.30	\$ (0.30)	\$ (0.44)	\$ 0.49	\$ 0.58	\$ 0.54	\$ 0.54	\$ 0.58



## BOARD OF DIRECTORS

### **Dan R. Barlow**

Retired Assistant Vice President of Bancshares  
and Executive Vice President,  
City President of First United Security

### **Linda H. Breedlove**

Retired Publisher and Editor of  
The South Alabamian, Inc.

### **Gerald P. Corgill**

President of Dozier Hardware Company, Inc.

### **Wayne C. Curtis**

Retired Director of Education and Regulatory Affairs with the  
Community Bankers Association of Alabama and Former  
Assistant Superintendent and Superintendent of Banks in the  
Alabama State Banking Department

### **John C. Gordon**

President of Forest Services, Inc. and  
President of SS&J Land Company, Inc.

### **William G. Harrison**

Timber Settlements and Records Manager for  
Linden Lumber Company

### **Hardie B. Kimbrough**

Of Counsel with the Gilmore Law Office and  
Retired Presiding Circuit Judge for the  
First Judicial Circuit of the State of Alabama

### **Jack W. Meigs**

Circuit Judge for the Fourth Judicial Circuit  
of the State of Alabama

### **R. Terry Phillips**

President and Chief Executive Officer of  
Bancshares and First United Security

### **Ray Sheffield**

Retired Owner of Deas Insurance Agency and  
West Alabama Insurance Agency and Former Sheriff of  
Clarke County

### **James C. Stanley**

Retired Dentist

### **Howard M. Whitted**

Retired Forester for Weyerhaeuser and  
Forester for Whitted Family Timberlands

### **Bruce N. Wilson**

Partner in the Law Firm of Wilson & Drinkard

## EXECUTIVE OFFICERS

### **R. Terry Phillips**

President and Chief Executive Officer of  
Bancshares and First United Security

### **Robert Steen**

Assistant Vice President, Assistant Treasurer,  
Principal Financial Officer and Principal Accounting  
Officer of Bancshares and Executive Vice President  
and Chief Financial Officer of First United Security

### **Larry M. Sellers**

Vice President, Secretary and Treasurer of  
Bancshares and Senior Executive Vice President  
and Chief Administrative Officer of  
First United Security

### **William D. Morgan**

Assistant Vice President and Assistant Secretary  
of Bancshares and Executive Vice President, Loan  
Administration of First United Security

### **J. Daniel Matheson, III**

Investment Officer of Bancshares, Senior Vice President,  
Investment Officer of First United Security and  
Chief Executive Officer, President and Secretary of R2Metrics, Inc.

# FIRST UNITED SECURITY BANK

## BRANCH LOCATIONS

### CORPORATE OFFICE

131 West Front Street  
Thomasville, Alabama 36784  
(334) 636-5424

### SOUTHERN REGION

Jimmy D. Sheffield, Regional Manager

Charlton F. Anderson, Branch Manager  
32451 Highway 43 South  
Thomasville, AL 36784  
(334) 637-0078

Richard B. Harvey, Branch Manager  
131 Main Street  
Grove Hill, AL 36451  
(251) 275-4111

Jimmy D. Sheffield, Acting Branch Manager  
688 Highway 84  
Coffeeville, AL 36524  
(251) 276-3291

Donna A. Bedwell, Branch Manager  
33445 Highway 43 North  
Thomasville, AL 36784  
(334) 636-5429

Richard B. Harvey, Branch Manager  
102 Cobb Street  
Grove Hill, AL 36451  
(251) 275-4380

Georgia R. Dozier, Branch Manager  
305 South Mulberry Avenue  
Butler, AL 36904  
(205) 459-3011

Richard B. Harvey, Branch Manager  
1910 Highway 178  
Fulton, AL 36446  
(334) 636-5474

Margaret Pritchard, Acting Branch Manager  
2101 College Avenue  
Jackson, AL 36545  
(251) 246-2445

Sonja M. Brown, Branch Manager  
43 Melvin Road  
Gilbertown, AL 36908  
(251) 843-2211

Margaret Pritchard, Acting Branch Manager  
208 Commerce Street  
Jackson, AL 36545  
(251) 246-1505

### NORTHERN REGION

Richard Key, Regional Manager

Willie R. Dunn, Branch Manager  
2334 Main Street  
Brent, AL 35034  
(205) 926-4627

Lindsay Hubbard, Branch Manager  
22170 Highway 216  
McCalla, AL 35111  
(205) 477-4623

Terry A. Meggs, Branch Manager  
8710 Highway 69 South  
Tuscaloosa, AL 35405  
(205) 242-0044

Ken Cottingham, Branch Manager  
135 Belcher Street  
Centreville, AL 35042  
(205) 926-4861

Parrish B. Argo, Branch Manager  
62 Wheat Street  
Harpersville, AL 35078  
(205) 672-8752

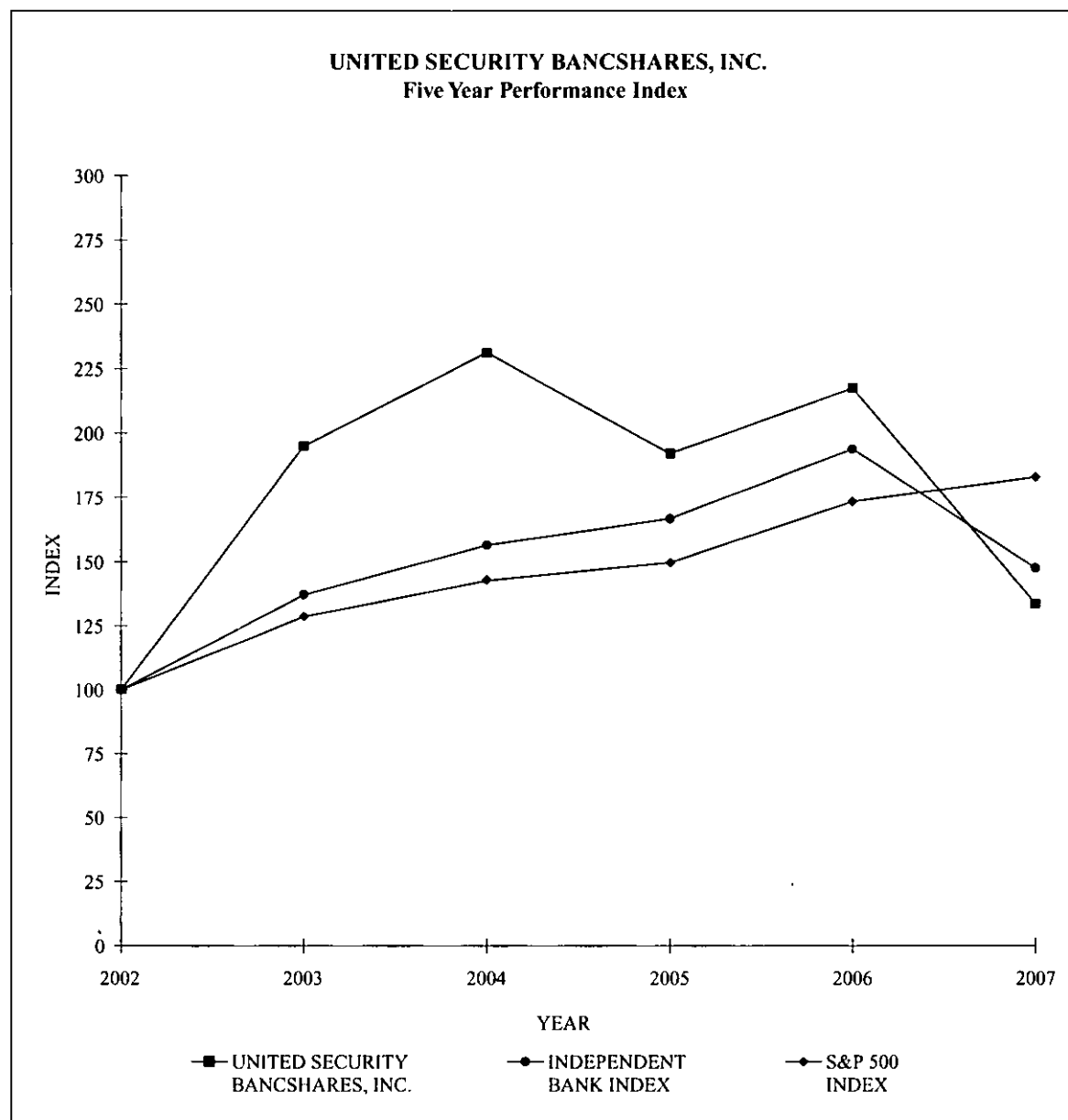
Edwin E. Brasher, Branch Manager  
225 West College Street  
Columbiana, AL 35051  
(205) 669-3550

Billie M. Hudson, Branch Manager  
20041 Highway 11  
Woodstock, AL 35188  
(205) 938-7873

Wayne Norman, Branch Manager  
4720 Highway 31 South  
Calera, AL 35040  
(205) 668-0425

## COMPARATIVE STOCK PERFORMANCE

The following graph compares cumulative total shareholder returns on Bancshares' common stock for the five years ended December 31, 2007, with that of The Standard & Poor's 500 Stock Index ("S&P 500 Index") and the Carson Medlin Company's Independent Bank Index, which covers 27 independent community banks located in the Southeastern United States including Alabama, Florida, Georgia, North Carolina, South Carolina, Tennessee, Virginia and West Virginia (the "Independent Bank Index"). The graph shows the comparative values for \$100 invested on December 31, 2002, assuming reinvestment of dividends.<sup>1</sup>



UNITED SECURITY BANCSHARES, INC.

INDEPENDENT BANK INDEX

S&P 500 INDEX

2002	2003	2004	2005	2006	2007
100	195	231	192	217	134
100	137	156	167	194	147
100	129	143	150	173	183

<sup>1</sup>Source: The Carson Medlin Company.

## C O R P O R A T E   I N F O R M A T I O N

### COMMON STOCK

United Security Bancshares, Inc. common stock is listed on the NASDAQ Capital Market and is traded under the symbol USBI and Cusip number 911459105. As of March 20, 2008, there were 6,060,427 outstanding shares, 7,317,560 issued shares, and approximately 899 shareholders.

### CORPORATE OFFICES

131 West Front Street / P.O. Box 249  
Thomasville, Alabama 36784  
Telephone: (334) 636-5424

### STOCK MARKET INFORMATION

The Company has declared cash dividends on its common Stock on a quarterly basis in the past three years as follows:

<u>Fiscal Year</u>	<u>Dividends Declared On Common Stock (Per Annum)</u>
2005	\$0.95
2006	1.07
2007	1.19

Dividends are paid at the discretion of the Company's Board of Directors, based on the Company's operating performance and financial position, including earnings, capital and liquidity. Dividends from the Bank are the Company's primary source of funds for the payment of dividends to shareholders, and there are various legal and regulatory limits regarding the extent to which the Bank may pay dividends or otherwise supply funds to the Company. In addition, federal and state regulatory agencies have the authority to prevent the Company from paying a dividend to shareholders. While the Company intends to continue paying dividends, it can make no assurances that it will be able to or be permitted to do so in the future. See Note 14, "Shareholders Equity," in the "Notes to Consolidated Financial Statements," included in this Annual Report.

The sale price ranges by quarter for 2006 and 2007 are as follows:

<u>2006</u>	<u>High</u>	<u>Low</u>
First Quarter	\$31.45	\$25.00
Second Quarter	30.15	24.50
Third Quarter	29.23	27.00
Fourth Quarter	29.41	27.00

<u>2007</u>	<u>High</u>	<u>Low</u>
First Quarter	\$30.68	\$28.15
Second Quarter	30.25	25.00
Third Quarter	25.90	22.30
Fourth Quarter	24.43	15.22

### LEGAL COUNSEL

Maynard, Cooper & Gale, P.C.  
1901 Sixth Avenue North, Suite 2400  
Birmingham, Alabama 35203  
Telephone: (205) 254-1000

### AUDITORS

Mauldin & Jenkins, LLC  
2000 Southbridge Parkway, Suite 501  
Birmingham, Alabama 35209  
Telephone: (205) 445-2880

### TRANSFER & PAYING AGENT

Registrar and Transfer Company  
10 Commerce Drive  
Cranford, New Jersey 07016  
Telephone: 1-800-368-5948

### MARKET MAKERS

Ryan Beck & Company  
220 South Orange Avenue  
Livingston, New Jersey 07039  
Telephone: (973) 597-5875

Sterne, Agee & Leach, Inc.  
2800 Dauphin Street, Suite 102  
Mobile, Alabama 36606  
Telephone: 1-877-607-8625

Wachovia Securities  
Colonial Bank Building, Suite 220  
41 West I-65 Service Road North  
Mobile, Alabama 36608  
Telephone: 1-800-251-4389

### FINANCIAL PUBLICATIONS

Form 10-K is the Company's annual report filed with the Securities and Exchange Commission. A copy of this report is available on the SEC's website at [www.sec.gov](http://www.sec.gov) and also is available without charge upon written request to Larry M. Sellers, Secretary, United Security Bancshares, Inc., at the corporate offices.

**United Security Bancshares, Inc.**

131 West Front Street

P.O. Box 249

Thomasville, Alabama 36784

Telephone: 334-636-5424

[www.firstusbank.com](http://www.firstusbank.com)

**END**